Testimony of

America's Community Bankers

on

Financial Services Regulatory Relief: Private Sector Perspectives

before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

Of the

United States House of Representatives

On

May 19, 2005

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And

Second Vice Chairman
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Chairman Bachus, Congressman Sanders and Members of the Committee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $175 million state chartered community bank, part of a two bank mutual holding company. I also serve as CEO of the holding company.

I am here this morning representing America's Community Bankers. I am the Second Vice Chairman of ACB's Board of Directors. I want to thank Chairman Bachus, Congressman Hensarling and Congressman Moore of Kansas for their leadership in addressing the impact of outdated and unnecessary regulations on community banks and the communities they serve.

ACB is pleased to have this opportunity to discuss recommendations to reduce the regulatory burden placed on community banks. Many of ACB's specific recommendations for regulatory relief have been included in regulatory relief legislation adopted by the Financial Services Committee and the House, including the Financial Services Regulatory Relief Act of 2004 (H.R. 1375). The House adopted H.R. 1375 by an overwhelming bipartisan vote of 392 to 25. We greatly appreciate the past support of the Financial Institutions Subcommittee and the Financial Services Committee for these proposals, and we hope the Members of the Committee will support those provisions and others that we will discuss today.

When unnecessary and costly regulations are eliminated or simplified, community banks will be able to better serve consumers and small businesses in their local markets. ACB has a long-standing position in support of meaningful reduction of regulatory burden.

This hearing and this topic are important and timely. Community banks operate under a regulatory scheme that becomes more and more burdensome every year. Ten years ago there were 12,000 banks in the US. Today, there are only 9,000 left. ACB is concerned that community banks are becoming less and less able to compete with financial services conglomerates and unregulated companies that offer similar products and services without the same degree of regulation and oversight Community banks stand at the heart of cities and towns everywhere and to lose that segment of the industry because of over regulation would be debilitating to those communities.

Community banks today are subject to a host of laws, some over a half-century old that originally were enacted to address concerns that no longer exist. These laws stifle innovation in the banking industry and put up needless roadblocks to competition without contributing to the safety and soundness of the banking system. Further, every new law that impacts community banks brings with it additional requirements and burdens. This results in layer upon layer of regulation promulgated by the agencies frequently without regard to the requirements already in existence.

The burden of these laws results in lost business opportunities for community banks. But, consumers and businesses also suffer because their choices among financial institutions and financial products are more limited as a result of these laws, and, in the end, less competition means consumers and businesses pay more for these services.

Community banks must also comply with an array of consumer compliance regulations. As a community banker, I understand the importance of reasonable consumer protection regulations. As a community banker, I also see how much it costs, both financially and in numbers of staff hours for my small mutual community bank to comply with the often-unreasonable application of these laws. As a community banker, I see projects that will not be funded, products not offered and consumers not served because I have had to make a large resource commitment to comply with the same regulations with which banks hundreds of times larger must comply.

Bankers are not the only ones concerned about the impact of the increasing layers of regulation on community banks. According to FDIC Vice Chairman John Reich, the bank and savings association regulatory agencies have promulgated over 800 regulations since 1989. In the opinion of the Vice Chairman, although most of the rule changes were put in place for good, sound reasons, over 800 changes in 15 years are a lot for banks to digest, particularly smaller community banks with very limited staff. Vice Chairman Reich believes that regulatory burden will play an increasingly significant role in the viability of community banks in the future. I agree.

Before turning to specific recommendations for legislative changes, I would like to discuss two areas where the implementation of laws by the regulators has been carried out in a fashion that creates unnecessary uncertainty and burden on community banks, namely, anti-money laundering and corporate governance.

Community bankers fully support the goals of the anti-money laundering laws, and we are prepared to do our part in the fight against crime and terrorism. As laudable as these goals are, there currently exists an atmosphere of uncertainly and confusion about what is required of banks. This results from inconsistent messages being given by regulatory staff in the field, the region and Washington. For example, Washington officials repeatedly assure the banking industry that the banking agencies do not have a "zero-tolerance" policy, where every minor discrepancy is treated as a significant failure to comply with the law. Nevertheless, regional offices and individual examiners continue to articulate a "zero-tolerance policy" when conducting BSA examinations and when making presentations during industry conferences. In another example of inconsistent policy, FinCEN has admonished banks not to file "defensive suspicious activity reports," but as recent enforcement actions taken by the banking agencies and prosecutions by the Department of Justice demonstrate, it is safer for banks to file SARs, when in doubt.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers.

ACB and other industry representatives have been working with FinCEN and the banking regulators to improve the regulation of our anti-money laundering efforts. As a result of this dialogue, FinCEN and the banking agencies recently issued joint guidance to banks on what level of scrutiny they should use with respect to the accounts of money service businesses. ACB

commends the agencies for providing this needed clarification of bank responsibilities. ACB will continue to work with government agencies to provide further clarification of the responsibilities of banks under the nation's anti-money laundering laws. We look forward to the release of additional guidance in this area and are pleased that the agencies have planned training sessions for examiners and bankers so that a consistent message can be given to everyone at the same time.

The Sarbanes-Oxley Act contained much needed reforms, restoring investor confidence in the financial markets that were in turmoil as a result of the major corporate scandals at the beginning of this decade. Community bankers support that Act and other laws, like the Federal Deposit Insurance Corporation Improvement Act, that improve corporate governance, enhance investor protection and promote the safety and soundness of the banking system. However, the implementation of the Sarbanes-Oxley Act by the Securities and Exchange Commission and the Public Company Accounting Oversight Board and the interpretation of those regulatory requirements by accounting firms have resulted in costly and burdensome unintended consequences for community banks, including, even, privately held stock institutions and mutual institutions.

For example, the PCAOB requires the external auditor to audit the internal controls of a company, rather than audit the CEO's attestation with respect to the internal controls -- which was the practice generally permitted by the banking agencies for compliance with FDICIA's internal control requirements. ACB believes that this change in practice is a significant cause of a dramatic increase in bank audit fees. Many publicly traded banks are reporting an increase in

audit fees of 75percent over the prior year. Some banks are reporting audit fees equal to 20percent of net income. Privately held and mutual banks also are experiencing significant increases in auditing fees because the external auditors are applying the same PCAOB standards to these non-public banks.

ACB has provided concrete suggestions to the banking regulators, the SEC and the PCAOB on ways to reduce the cost of compliance with internal controls and other requirements, while still achieving the important goal of improved corporate governance and transparency. We appreciate the separate guidance on internal control reporting and attestation requirements issued concurrently by the SEC and the PCAOB, and are hopeful that it might provide some relief to the escalating audit fees.

(We have attached a letter, which ACB recently submitted to the banking regulators, detailing these suggestions and also suggestions for improving anti-money laundering regulation.)

Legislative Recommendations

ACB has a number of recommendations to reduce regulations applicable to community banks that will help make doing business easier and less costly, further enabling community banks to help their communities prosper and create jobs. ACB's specific legislative proposals are attached in an appendix.

Priority Issues

Expanded Business Lending

A high priority for ACB is a modest increase in the business-lending limit for savings associations. In 1996, Congress liberalized the commercial lending authority for federally chartered savings associations by adding a 10 percent "bucket" for small business loans to the 10 percent limit on commercial loans. Today, savings associations are increasingly important providers of small business credit in communities throughout the country. As a result, even the "10 plus 10" limit poses a constraint for an ever-increasing number of institutions. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders. An increase in commercial lending authority would help increase small business access to credit, particularly in smaller communities where the number of financial institutions is limited. To accommodate this need, ACB supports eliminating the lending limit restriction on small business loans while increasing the aggregate lending limit on other commercial loans to 20 percent. Under ACB's proposal, these changes would be made without altering the requirement that 65 percent of an association's assets be maintained in assets required by the qualified thrift lender test.

Parity Under the Securities Exchange Act and Investment Advisers Act

ACB vigorously supports providing parity for savings associations with banks under the Securities Exchange Act and Investment Advisers Act. Statutory parity will ensure that savings associations and banks are under the same basic regulatory requirements when they are engaged in identical trust, brokerage and other activities that are permitted by law. As more savings associations engage in trust activities, there is no substantive reason to subject them to different

requirements. They should be subject to the same regulatory conditions as banks engaged in the same services.

In proposed regulations, the SE C has offered to remove some aspects of the disparity in treatment for broker-dealer registration and the IAA, but still has not offered full parity. Dual regulation by the OTS and the SEC makes savings associations subject to significant additional cost and regulatory burden. Eliminating this regulatory burden could free up tremendous resources for local communities. ACB supports a legislative change. Such a change will ensure that savings associations will have the same flexibility as banks to develop future products and offer services that meet customers' needs.

Easing Restrictions on Interstate Banking and Branching

ACB strongly supports removing unnecessary restrictions on the ability of national and state banks to engage in interstate branching. Currently, national and state banks may only engage in de novo interstate branching if state law expressly permits. ACB recommends eliminating this restriction. The law also should clearly provide that state-chartered Federal Reserve member banks may establish de novo interstate branches under the same terms and conditions applicable to national banks. ACB recommends that Congress eliminate states' authority to prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that has not existed for at least five years. The new branching rights should not be available to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from non-financial activities).

Other Important Issues

Interest on Business Checking

Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary and anti-competitive. Restrictions on these accounts make community banks less competitive in their ability to serve the financial needs of many business customers. Permitting banks and savings institutions to pay interest directly on demand accounts would be simpler. Institutions would benefit by not having to spend time and resources trying to get around the existing prohibition. This would benefit many community depository institutions that cannot currently afford to set up complex sweep operations for their – mostly small – business customers.

ACB supports the approach taken in H.R. 1224, Business Checking Freedom Act of 2005, as adopted by the Financial Services Committee on April 27, 2005.

Eliminating Unnecessary Branch Applications

A logical counterpart to proposals to streamline branching and merger procedures would be to eliminate unnecessary paperwork for well-capitalized banks seeking to open new branches. National banks, state-chartered banks, and savings associations are each required to apply and await regulatory approval before opening new branches. This process unnecessarily delays institutions' plans to increase competitive options and increase services to consumers, while serving no important public policy goal. In fact, these requirements are an outdated holdover from the times when regulatory agencies spent unnecessary time and effort to determine whether a new branch would serve the "convenience and needs" of the community.

Coordination of State Examination Authority

ACB supports the adoption of legislation clarifying the examination authority over state-chartered banks operating on an interstate basis. ACB recommends that Congress clarify home- and host-state authority for state-chartered banks operating on an interstate basis. This would reduce the regulatory burden on those banks by making clear that a chartering state bank supervisor is the principal state point of contact for safety and soundness supervision and how supervisory fees may be assessed. These reforms will reduce regulatory costs for smaller institutions.

Limits on Commercial Real Estate Loans

ACB recommends increasing the limit on commercial real estate loans, which applies to savings associations, from 400 to 500 percent of capital, and giving the OTS flexibility to increase that limit. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility. Congress could direct the OTS to establish practical guidelines for non-residential real property lending that exceeds 500 percent of capital.

Loans to One Borrower

ACB recommends eliminating the $500,000-per-unit limit in the residential housing development provision in the loans-to-one-borrower section of the Home Owners' Loan Act. This limit frustrates the goal of advancing residential development within the statute's overall limit – the lesser of $30 million or 30 percent of capital. This overall limit is sufficient to prevent

concentrated lending to one borrower/housing developer. The per-unit limit is an excessive regulatory detail that creates an artificial market restriction in high-cost areas.

Home Office Citizenship

ACB recommends that Congress amend the Home Owners' Loan Act to provide that for purposes of jurisdiction in federal courts, a federal savings association is deemed to be a citizen of the State in which it has its home office. For purposes of obtaining diversity jurisdiction in federal court, the courts have found that a federal savings association is considered a citizen of the state in which it is located only if the association's business is localized in one State. If a federal savings association has interstate operations, a court may find that the federally chartered corporation is not a citizen of any state, and therefore no diversity of citizenship can exist. The amendment would provide certainty in designating the state of their citizenship.

A recent court decision has cast doubt on national banks' ability to access the federal courts on the basis of diversity jurisdiction. Regulatory relief legislation should also clarify that national banks are citizens of their home states for diversity jurisdiction purposes.

Interstate Acquisitions

ACB supports the adoption of legislation to permit multiple savings and loan holding companies to acquire associations in other states under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. This would eliminate restrictions in current law that prohibit (with certain exceptions) a savings and loan holding company from acquiring a savings association if that would cause the holding

company to become a multiple savings and loan holding company controlling savings associations in more than one state.

Application of QTL to Multi-State Operations

ACB supports legislation to eliminate state-by-state application of the QTL test. This better reflects the business operations of savings associations operating in more than one state.

Applying International Lending Supervision Act to OTS

ACB recommends that the ILSA be amended to clarify that the ILSA covers savings associations. Such a provision would benefit OTS-regulated savings associations operating in foreign countries by assisting the OTS in becoming recognized as a consolidated supervisor, and it would promote consistency among the federal banking regulators in supervising the foreign activities of insured depository institutions.

OTS Representation on Basel Committee on Banking Supervision

ACB recommends another amendment to the ILSA that would add OTS to the multi-agency committee that represents the United States before the Basel Committee on Banking Supervision. Savings associations and other housing lenders would benefit by having the perspective of the OTS represented during the Basel Committee's deliberation.

Parity for Savings Associations Acting as Agents for Affiliated Depository Institutions

ACB recommends that the Federal Deposit Insurance Act be amended to give savings associations parity with banks to act as agents for affiliated depository institutions. This change will allow more consumers to access banking services when they are away from home.

Inflation Adjustment under the Depository Institution Management Interlocks Act

ACB supports increasing the exemption for small depository institutions under the DIMA from $20 million to $100 million. This will make it easier for smaller institutions to recruit high quality directors. The original $20 million level was set a number of years ago and is overdue for an adjustment.

Reducing Debt Collection Burden

Under the Fair Debt Collection Practices Act, a debtor has 30 days in which to dispute a debt. ACB supports legislation that makes clear that a debt collector need not stop collection efforts for that 30-day period while the debtor decides whether or not to dispute the debt. This removes an ambiguity that has come up in some instances. If a collector has to cease action for 30 days, valuable assets, which may be sufficient to satisfy the debt, may vanish during the 30-day period.

Mortgage Servicing Clarification

The FDCPA requires a debt collector to issue a "mini-Miranda" warning (that the debt collector is attempting to collect a debt and any information obtained will be used for that purpose) when the debt collector begins to attempt to collect a debt. This alerts the borrower that

his debt has been turned over to a debt collector. However, the requirement also applies in cases where a mortgage servicer purchases a pool of mortgages that include delinquent loans. While the mini-Miranda warnings are clearly appropriate for true third party debt collection activities, they are not appropriate for mortgage servicers who will have an ongoing relationship with the borrower.

ACB urges the adoption of legislation to exempt mortgage servicers from the mini-Miranda requirements. The proposed exemption (based on H.R. 314, the Mortgage Servicing Clarification Act) is narrowly drawn and would apply only to first lien mortgages acquired by a mortgage servicer for whom the collection of delinquent debts is incidental to its primary function of servicing current mortgages. The exemption is narrower than one recommended by the FTC for mortgage servicers. The amendment would not exempt mortgage servicers from any other requirement of the FDCPA.

Repealing Overlapping Rules for Purchased Mortgage Servicing Rights

ACB supports eliminating the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. ACB's proposal would permit insured depository institutions to value purchased mortgage servicing rights, for purposes of certain capital and leverage requirements, at more than 90 percent of fair market value – up to 100 percent – if the federal banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions.

Loans to Executive Officers

ACB recommends legislation that eliminates the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loans, i.e., those other than housing, education, and certain secured loans. This would conform the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit. ACB believes that this limit is sufficient to maintain safety and soundness.

Decriminalizing RESPA

ACB recommends striking the imprisonment sanction for violations of RESPA. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. Under the ACB's proposal, the possibility of a $10,000 fine would remain in the law, which would provide adequate deterrence.

Bank Service Company Investments

Present federal law stands as a barrier to a savings association customer of a Bank Service Company from becoming an investor in that BSC. A savings association cannot participate in the BSC on an equal footing with banks who are both customers and owners of the BSC. Likewise, present law blocks a bank customer of a savings association's service corporation from investing in the savings association service corporation.

ACB proposes legislation that would provide parallel investment ability for banks and savings associations to participate in both BSCs and savings association service corporations.

ACB's proposal preserves existing activity limits and maximum investment rules and makes no change in the roles of the federal regulatory agencies with respect to subsidiary activities of the institutions under their primary jurisdiction. Federal savings associations thus would need to apply only to OTS to invest.

Eliminating Savings Association Service Company Geographic Restrictions

Currently, savings associations may only invest in savings association service companies in their home state. ACB supports legislation that would permit savings associations to invest in those companies without regard to the current geographic restrictions.

Streamlining Subsidiary Notifications

ACB recommends that Congress eliminate the unnecessary requirement that a state savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. Under ACB's proposal, a savings association would still be required to notify the OTS, providing sufficient regulatory oversight.

Authorizing Additional Community Development Activities

Federal savings associations cannot now invest directly in community development corporations, and must do so through a service corporation. National banks and state member banks are permitted to make these investments directly. Because many savings associations do not have a service corporation and choose for other business reasons not to establish one, they are not able to invest in CDCs. ACB supports legislation to extend CDC investment authority to federal savings associations under the same terms as currently apply to national banks.

Eliminating Dividend Notice Requirement

Current law requires a savings association subsidiary of a savings and loan holding company to give the OTS 30 days' advance notice of the declaration of any dividend. ACB supports the elimination of the requirement for well-capitalized associations that would remain well capitalized after they pay the dividend. Under this approach, these institutions could conduct routine business without regularly conferring with the OTS. Those institutions that are not well capitalized would be required to pre-notify the OTS of dividend payments.

Reimbursement for the Production of Records

ACB's members have long supported the ability of law enforcement officials to obtain bank records for legitimate law enforcement purposes. In the Right to Financial Privacy Act of 1978, Congress recognized that it is appropriate for the government to reimburse financial institutions for the cost of producing those records. However, that act provided for reimbursement only for producing records of individuals and partnerships of five or fewer individuals. Given the increased demand for corporate records, such as records of organizations that are allegedly fronts for terrorist financing, ACB recommends that Congress broaden the RFPA reimbursement language to cover corporate and other organization records.

ACB also recommends that Congress clarify that the RFPA reimbursement system applies to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (title III of the USA PATRIOT Act). Because financial

institutions will be providing additional records under the authority of this new act, it is important to clarify this issue.

Extending Divestiture Period

ACB recommends that unitary savings and loan holding companies that become multiple savings and loan holding companies be provided 10 years to divest non-conforming activities, rather than the current two-year period. This would be consistent with the time granted to new financial services holding companies for similar divestiture under the Gramm-Leach-Bliley Act. The longer time gives these companies time to conform to the law without forcing a fire-sale divestiture.

Restrictions on Auto Loan Investments

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. ACB recommends eliminating this restriction. Removing this limitation will expand consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

Streamlined CRA Examinations

ACB strongly supports amending the Community Reinvestment Act to define banks with less than $1 billion dollars in assets as small banks and therefore permit them to be examined with the streamlined small institution examination. According to a report by the Congressional Research Service, a community bank participating in the streamlined CRA exam can save 40 percent in compliance costs. Expanding the small institution exam program will free up capital

and other resources for almost 1,700 community banks across our nation that are in the $250 million to $1 billion asset-size range, allowing them to invest even more into their local communities.

Credit Card Savings Associations

Under current law, a savings and loan holding company cannot own a credit card savings association and still be exempt from the activity restrictions imposed on companies that control multiple savings associations. However, a savings and loan holding company could charter a credit card institution as a national or state bank and still be exempt from the activity restrictions imposed on multiple savings and loan holding companies. ACB proposes that the Home Owners' Loan Act be amended to permit a savings and loan holding company to charter a credit card savings association and still maintain its exempt status. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.

Protection of Information Provided to Banking Agencies

Recent court decisions have created ambiguity about the privileged status of information provided by depository institutions to bank supervisors. ACB recommends the adoption of legislation that makes clear that when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Such legislation would facilitate the free flow of information between banking regulators and depository institutions that is needed to maintain the safety and soundness of our banking system.

Conclusion

I wish to again express ACB's appreciation for your invitation to testify on the importance of reducing regulatory burdens and costs for community banks. We strongly support the Committee's efforts in providing regulatory relief, and look forward to working with you and your staff in crafting legislation to accomplish this goal.

Appendix A

to

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Contents

Expanded Business Lending

SEC. __. SMALL BUSINESS AND OTHER COMMERCIAL LOANS –

(a) ELIMINATION OF LENDING LIMIT ON SMALL BUSINESS LOANS- Section 5(c)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(1)) is amended by inserting after subparagraph (V) (as added by section 208 of this title) the following new subparagraph:

> `(W) SMALL BUSINESS LOANS- Small business loans, as defined in regulations which the Director shall prescribe.'

(b) INCREASE IN LENDING LIMIT ON OTHER BUSINESS LOANS- Section 5(c)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(A)) is amended by striking `, and amounts in excess of 10 percent' and all that follows through `by the Director'.

Explanation

This would eliminate the lending limit on small business loans and increase the lending limit on other business loans from 10 percent to 20 percent of assets. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, enhancing their role as community lenders.

Parity for Savings Associations Under the Securities Exchange Act and Investment Advisers Act

SEC.__. PARITY FOR SAVINGS ASSOCIATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND THE INVESTMENT ADVISERS ACT OF 1940.

(a) SECURITIES EXCHANGE ACT OF 1934-

(1) DEFINITION OF BANK- Section 3(a)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(6)) is amended—

(A) in subparagraph (A), by inserting `or a Federal savings association, as defined in section 2(5) of the Home Owners' Loan Act' after `a banking institution organized under the laws of the United States'; and

(B) in subparagraph (C)—

(i) by inserting `or savings association as defined in section 2(4) of the Home Owners' Loan Act,' after `banking institution,'; and

(ii) by inserting `or savings associations' after `having supervision over banks'.

(2) INCLUDE OTS UNDER THE DEFINITION OF APPROPRIATE REGULATORY AGENCY FOR CERTAIN PURPOSES- Section 3(a)(34) of such Act (15 U.S.C. 78c(a)(34)) is amended—

(A) in subparagraph (A)—

(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';

(ii) by striking `and' at the end of clause (iii);

(iii) by redesignating clause (iv) as clause (v); and

(iv) by inserting the following new clause after clause (iii):

`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, a subsidiary or a department or division of any such savings association, or a savings and loan holding company; and';

(B) in subparagraph (B)—

(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';

(ii) by striking `and' at the end of clause (iii);
(iii) by redesignating clause (iv) as clause (v); and
(iv) by inserting the following new clause after clause (iii):
`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such savings association, or a savings and loan holding company; and';

(C) in subparagraph C—
(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';
(ii) by striking `and' at the end of clause (iii);
(iii) by redesignating clause (iv) as clause (v); and
(iv) by inserting the following new clause after clause (iii):
`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, a savings and loan holding company, or a subsidiary of a savings and loan holding company when the appropriate regulatory agency for such clearing agency is not the Commission; and';

(D) in subparagraph (D)—
(i) by striking `and' at the end of clause (ii);
(ii) by redesignating clause (iii) as clause (iv); and
(iii) by inserting the following new clause after clause (ii):
`(iii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation; and';

(E) in subparagraph (F)—
(i) by redesignating clauses (ii), (iii), and (iv) as clauses (iii), (iv), and (v), respectively; and
(ii) by inserting the following new clause after clause (i):
`(ii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation; and';
and

(F) at the end of the last undesignated paragraph, by inserting the following new sentence: `As used in this paragraph, the term `savings and

loan holding company' has the meaning given it in section 10(a) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)).'.

(b) INVESTMENT ADVISERS ACT OF 1940-

(1) DEFINITION OF BANK- Section 202(a)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(2)) is amended—

(A) in subparagraph (A) by inserting `or a Federal savings association, as defined in section 2(5) of the Home Owners' Loan Act' after `a banking institution organized under the laws of the United States'; and

(B) in subparagraph (C)—

(i) by inserting `, savings association as defined in section 2(4) of the Home Owners' Loan Act,' after `banking institution'; and

(ii) by inserting `or savings associations' after `having supervision over banks'.

(2) CONFORMING AMENDMENTS- Subsections (a)(1)(A)(i), (a)(1)(B), (a)(2), and (b) of section 210A of such Act (15 U.S.C. 80b-10a), as added by section 220 of the Gramm-Leach-Bliley Act, are each amended by striking `bank holding company' each place it occurs and inserting `bank holding company or savings and loan holding company'.

(c) CONFORMING AMENDMENT TO THE INVESTMENT COMPANY ACT OF 1940- Section 10I of the Investment Company Act of 1940 (15 U.S.C. 80a-10I), as amended by section 213I of the Gramm-Leach-Bliley Act, is amended by inserting after `1956)' the following: `or any one savings and loan holding company (together with its affiliates and subsidiaries) (as such terms are defined in section 10 of the Home Owners' Loan Act)'.

Explanation

This amendment provides parity for savings associations with banks under the Securities Exchange Act and Investment Advisers Act. The provision will ensure that savings associations and banks are under the same basic regulatory requirements when they are engaged in identical trust, brokerage and other activities that are permitted by law.

Easing Restrictions on Interstate Banking and Branching

SEC. ___. EASING RESTRICTIONS ON INTERSTATE BRANCHING AND MERGERS.

(a) DE NOVO INTERSTATE BRANCHES OF NATIONAL BANKS-

(1) IN GENERAL- Section 5155(g)(1) of the Revised Statutes of the United States (12 U.S.C. 36(g)(1)) is amended by striking `maintain a branch if--' and all that follows through the end of subparagraph (B) and inserting `maintain a branch.'.

(2) CLERICAL AMENDMENT- The heading for subsection (g) of section 5155 of the Revised Statutes of the United States is amended by striking `STATE `OPT-IN' ELECTION TO PERMIT'.

(b) DE NOVO INTERSTATE BRANCHES OF STATE NONMEMBER BANKS-

(1) IN GENERAL- Section 18(d)(4)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(4)(A)) is amended by striking `maintain a branch if--' and all that follows through the end of clause (ii) and inserting `maintain a branch.'.

(2) INTERSTATE BRANCHING BY SUBSIDIARIES OF COMMERCIAL FIRMS PROHIBITED- Section 18(d)(3)) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(3)) is amended by adding at the end the following new subparagraph:

`(C) INTERSTATE BRANCHING BY SUBSIDIARIES OF COMMERCIAL FIRMS PROHIBITED-

`(i) IN GENERAL- If the appropriate State bank supervisor of the home State of any industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956, or the appropriate State bank supervisor of any host State with respect to such company, bank, or institution, determines that such company, bank, or institution is controlled, directly or indirectly, by a commercial firm, such company, bank, or institution may not acquire, establish, or operate a branch in such host State.

`(ii) COMMERCIAL FIRM DEFINED- For purposes of this subsection, the term `commercial firm' means any entity at least 15 percent of the annual gross revenues of which on a consolidated basis, including all affiliates of the entity, were derived from engaging, on an on-going basis, in activities that are not financial in nature or incidental to a financial activity during at least 3 of the prior 4 calendar quarters.

`(iii) GRANDFATHERED INSTITUTIONS- Clause (i) shall not apply with respect to any industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956--

`(I) which became an insured depository institution before October 1, 2003 or pursuant to an application for deposit insurance which was approved by the Corporation before such date; and

`(II) with respect to which there is no change in control, directly or indirectly, of the company, bank, or institution after September 30, 2003, that requires an application under subsection (c), section 7(j), section 3 of the Bank Holding Company Act of 1956, or section 10 of the Home Owners' Loan Act.

`(iv) TRANSITION PROVISION- Any divestiture required under this subparagraph of a branch in a host State shall be completed as quickly as is reasonably possible.

`(v) CORPORATE REORGANIZATIONS PERMITTED- The acquisition of direct or indirect control of the company, bank, or institution referred to in clause (iii)(II) shall not be treated as a `change in control' for purposes of such clause if the company acquiring control is itself directly or indirectly controlled by a company that was an affiliate of such company, bank, or institution on the date referred to in clause (iii)(II), and remained an affiliate at all times after such date.'.

(3) TECHNICAL AND CONFORMING AMENDMENTS- Section 18(d)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(4)) is amended--

(A) in subparagraph (A) by striking `Subject to subparagraph (B)' and inserting `Subject to subparagraph (B) and paragraph (3)(C)'; and

(B) in subparagraphs (D) and (E), by striking `The term' and inserting `For purposes of this subsection, the term'.

(4) CLERICAL AMENDMENT- The heading for paragraph (4) of section 18(d) of the Federal Deposit Insurance Act is amended by striking `STATE `OPT-IN' ELECTION TO PERMIT INTERSTATE' and inserting `INTERSTATE'.

(c) DE NOVO INTERSTATE BRANCHES OF STATE MEMBER BANKS- The 3rd undesignated paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 321) is amended by adding at the end the following new sentences: `A State member bank may establish and operate a de novo branch in a host State (as such terms are defined in section 18(d) of the Federal Deposit Insurance Act) on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of a de novo branch of a national bank in a host State under section 5155(g) of the Revised Statutes of the United States or are applicable to an insured State nonmember bank under section 18(d)(3) of the Federal Deposit Insurance Act' after `Revised Statutes of the United States'. Such section 5155(g) shall be applied for purposes of the preceding sentence by substituting `Board of Governors of the Federal Reserve System' for `Comptroller of the Currency' and `State member bank' for `national bank'.'.

(d) INTERSTATE MERGER OF BANKS-

(1) MERGER OF INSURED BANK WITH ANOTHER DEPOSITORY INSTITUTION OR TRUST COMPANY- Section 44(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(a)(1)) is amended--

(A) by striking `Beginning on June 1, 1997, the' and inserting `The'; and

(B) by striking `insured banks with different home States' and inserting `an insured bank and another insured depository institution or trust company with a different home State than the resulting insured bank'.

(2) NATIONAL BANK TRUST COMPANY MERGER WITH OTHER TRUST COMPANY- Subsection (b) of section 4 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-1(b)) is amended to read as follows:

`(b) MERGER OF NATIONAL BANK TRUST COMPANY WITH ANOTHER TRUST COMPANY- A national bank that is a trust company may engage in a consolidation or merger under this Act with any trust company with a different home State, under the same terms and conditions that would apply if the trust companies were located within the same State.'.

(e) INTERSTATE FIDUCIARY ACTIVITY- Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by adding at the end the following new paragraph:

`(5) INTERSTATE FIDUCIARY ACTIVITY-

`(A) AUTHORITY OF STATE BANK SUPERVISOR- The State bank supervisor of a State bank may approve an application by the State bank, when not in contravention of home State or host State law, to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in a host State in which State banks or other corporations which come into competition with national banks are permitted to act under the laws of such host State.

`(B) NONCONTRAVENTION OF HOST STATE LAW- Whenever the laws of a host State authorize or permit the exercise of any or all of the foregoing powers by State banks or other corporations which compete with national banks, the granting to and the exercise of such powers by a State bank as provided in this paragraph shall not be deemed to be in contravention of host State law within the meaning of this paragraph.

`(C) STATE BANK INCLUDES TRUST COMPANIES- For purposes of this paragraph, the term `State bank' includes any State-chartered trust company (as defined in section 44(g)).

`(D) OTHER DEFINITIONS- For purposes of this paragraph, the term `home State' and `host State' have the meanings given such terms in section 44.'.

(f) TECHNICAL AND CONFORMING AMENDMENTS-

(1) Section 44 of the Federal Deposit Insurance Act (12 U.S.C. 1831u) is amended--

(A) in subsection (a)--

(i) by striking paragraph (4) and inserting the following new paragraph:

`(4) TREATMENT OF BRANCHES IN CONNECTION WITH CERTAIN INTERSTATE MERGER TRANSACTIONS- In the case of an interstate merger transaction which involves the acquisition of a branch of an insured depository institution or trust company without the acquisition of the insured depository institution or trust company, the branch shall be treated, for purposes of this section, as an insured depository institution or trust company the home State of which is the State in which the branch is located.'; and

(ii) by striking paragraphs (5) and (6) and inserting the following new paragraph:

`(5) APPLICABILITY TO INDUSTRIAL LOAN COMPANIES- No provision of this section shall be construed as authorizing the approval of any transaction involving a industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956, or the acquisition, establishment, or operation of a branch by any such company, bank, or institution, that is not allowed under section 18(d)(3).'.

(B) in subsection (b)--

(i) by striking `bank' each place such term appears in paragraph (2)(B)(i) and inserting `insured depository institution';

(ii) by striking `banks' where such term appears in paragraph (2)(E) and inserting `insured depository institutions or trust companies';

(iii) by striking `bank affiliate' each place such term appears in that portion of paragraph (3) that precedes subparagraph (A) and inserting `insured depository institution affiliate';

(iv) by striking `any bank' where such term appears in paragraph (3)(B) and inserting `any insured depository institution';

(v) by striking `bank' where such term appears in paragraph (4)(A) and inserting `insured depository institution and trust company'; and

(vi) by striking `all banks' where such term appears in paragraph (5) and inserting `all insured depository institutions and trust companies';

(C) in subsection (d)(1), by striking `any bank' and inserting `any insured depository institution or trust company';

(D) in subsection (e)--

(i) by striking `1 or more banks' and inserting `1 or more insured depository institutions'; and

(ii) by striking `paragraph (2), (4), or (5)' and inserting `paragraph (2)';

(E) by striking clauses (i) and (ii) of subsection (g)(4)(A) and inserting the following new clauses:

`(i) with respect to a national bank or Federal savings association, the State in which the main office of the bank or savings association is located; and

`(ii) with respect to a State bank, State savings association, or State-chartered trust company, the State by which the bank, savings association, or trust company is chartered; and';

(F) by striking paragraph (5) of subsection (g) and inserting the following new paragraph:

`(5) HOST STATE- The term `host State' means--

`(A) with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch; and

`(B) with respect to a trust company and solely for purposes of section 18(d)(5), a State, other than the home State of the trust company, in which the trust company acts, or seeks to act, in 1 or more fiduciary capacities.';
(G) in subsection (g)(10), by striking `section 18(c)(2)' and inserting `paragraph (1) or (2) of section 18(c), as appropriate,'; and
(H) in subsection (g), by adding at the end the following new paragraph:
`(12) TRUST COMPANY- The term `trust company' means--
`(A) any national bank;
`(B) any savings association; and
`(C) any bank, banking association, trust company, savings bank, or other banking institution which is incorporated under the laws of any State,
that is authorized to act in 1 or more fiduciary capacities but is not engaged in the business of receiving deposits other than trust funds (as defined in section 3(p)).'.
(2) Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)) is amended--
(A) in paragraph (1)--
(i) by striking subparagraphs (B) and (C); and
(ii) by redesignating subparagraph (D) as subparagraph (B); and
(B) in paragraph (5), by striking `subparagraph (B) or (D)' and inserting `subparagraph (B)'.
(3) Subsection (c) of section 4 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-1(c)) is amended to read as follows:
`(c) DEFINITIONS- For purposes of this section, the terms `home State', `out-of-State bank', and `trust company' each have the same meaning as in section 44(g) of the Federal Deposit Insurance Act.'.
(g) CLERICAL AMENDMENTS-
(1) The heading for section 44(b)(2)(E) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(b)(2)(E)) is amended by striking `BANKS' and inserting `INSURED DEPOSITORY INSTITUTIONS AND TRUST COMPANIES'.
(2) The heading for section 44(e) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(e)) is amended by striking `BANKS' and inserting `INSURED DEPOSITORY INSTITUTIONS'.

Explanation

This amendment removes prohibition on national and state banks from expanding through de novo interstate branching. Currently, this may occur only if a state's law expressly permits interstate branching. The amendment clarifies that a state member bank may establish a de novo interstate branch under the same terms and conditions applicable to national banks. The authority for a state to prohibit an out-of-state bank or bank holding company from acquiring, through merger or acquisition, an in-state bank that has not existed for at least five years is

eliminated. It also authorizes consolidations or mergers between an insured bank and a noninsured bank with different home states. The amendment would not apply to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from non-financial activities).

Interest on Business Checking

In the 109th Congress, ACB supported H.R. 1224, the Business Checking Freedom Act, as adopted by the House Financial Services Committee. H.R. 1224 repeals the Depression-era ban on interest bearing business checking accounts. In addition to permitting interest bearing checking accounts in banks and savings associations, the Committee's legislation permits certain industrial loan companies to offer interest-bearing business NOW accounts. This latter provision is restricted to certain grandfathered industrial loan companies and industrial loan companies with non-commercial parents. ACB supports the restriction on authority of industrial loan companies to offer interest-bearing business NOW accounts. ACB suggests the use of the language of H.R. 1224 as adopted by the Committee.

Eliminating Unnecessary Branch Applications

SEC. 1. BRANCH NOTIFICATION BY NATIONAL BANKS—Section 5155(i) of the Revised Statutes (12 U.S.C. 36(i)) is amended to read as follows:

> "(i) A national bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Comptroller within 30 calendar days."

SEC. 2. BRANCH NOTIFICATION BY STATE MEMBER BANKS—Section 22 of the Federal Reserve Act is amended by adding the following new subsection:

> "(i) A State member insured bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Board within 30 calendar days."

SEC. 3. BRANCH NOTIFICATION BY STATE NONMEMBER BANKS—Section 18(d)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(1)) is amended to read as follows:

> "(1) A State nonmember insured bank that is well-capitalized (as that term is defined in section 38 of this Act) may establish a branch, provided that it notifies the Corporation within 30 calendar days."

SEC. 4. BRANCH NOTIFICATION BY FEDERAL SAVINGS ASSOCIATIONS– Section 4(m)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(m)(1)) is amended to read as follows:

> "(1) IN GENERAL. A Federal savings association that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Director within 30 calendar days."

Explanation

Section 1 replaces a requirement that a national bank receive prior approval to open a branch with a provision that permits a national bank to establish a branch so long as it notifies the Comptroller within 30 calendar days.

Section 2 provides that a state member bank may open a branch so long as it notifies the Federal Reserve within 30 calendar days. This overrides the regulatory requirement of Regulation H (12 C.F.R. 208.6).

Section 3 replaces a requirement that a state nonmember bank receive prior approval to open a branch with a provision that permits a state nonmember bank to establish a branch so long as it notifies the FDIC within 30 calendar days.

Section 4 replaces a requirement that savings associations located in the District of Columbia obtain prior approval with a provision that permits any Federal savings association to establish a branch so long as it notifies the Director of OTS within 30 calendar days.

Under current regulatory practice, applications for new branches are routinely granted for strong institutions. Many other application requirements have been replaced with notification procedures. These amendments will expedite the ability of those institutions to open new branches, allowing them to more quickly offer services to additional communities, enhance competition.

Coordination of State Examination Authority

SEC. ____. COORDINATION OF STATE EXAMINATION AUTHORITY. Section 10(h) of the Federal Deposit Insurance Act (12 U.S.C. 1820(h)) is amended to read as follows:

"(h) COORDINATION OF EXAMINATION AUTHORITY.—

"(1) IN GENERAL.—The appropriate State bank supervisor of the home State of an insured State bank has authority to examine and supervise the bank. The State bank supervisor of the home State of an insured State bank shall exercise its authority to supervise and examine the branches of the bank in a host State in accordance with the terms of any applicable cooperative agreement between the home State bank supervisor and the State bank supervisor of the relevant host State. Except as expressly provided in a cooperative agreement between the State bank supervisors of the home State and host State(s) of an insured State bank, only the State bank supervisor of the home State of an insured State bank may levy or charge State supervisory fees on the bank.

"(2) HOST STATE EXAMINATION.—With respect to a branch operated in a host State by an out-of-State insured State bank that resulted from an interstate merger transaction approved under section 44 or that was established in such State pursuant to section 5155(g) of the Revised Statutes, the third undesignated paragraph of section 9 of the Federal Reserve Act or section 18(d)(4) of this Act, the appropriate State bank supervisor of such host State may—

"(A) with written notice to the State bank supervisor of the bank's home State and subject to the terms of any applicable cooperative agreement with the State bank supervisor of such home State, examine such branch for the purpose of determining compliance with host State laws that are applicable pursuant to section 24(j) of this Act, including those that govern community reinvestment, fair lending, and consumer protection; and

"(B) if expressly permitted under and subject to the terms of a cooperative agreement with the State bank supervisor of the bank's home State or if such out-of-State insured State bank has been determined to be in a troubled condition by either the State bank supervisor of the bank's home State or the bank's appropriate Federal banking agency, participate in the examination of the bank by the State bank supervisor of the bank's home State to ascertain that the activities of the branch in such host State are not conducted in an unsafe or unsound manner. The State bank supervisor of the home State of an insured State bank shall notify the State bank supervisor of each host State of the bank if there has been a final determination that the bank is in a troubled condition. The State bank supervisor of the bank's home State shall provide such notice as soon as reasonably possible but in all cases within 15 business days after the State bank supervisor has made such final determination or has received written notification of such final determination.

"(3) HOST STATE ENFORCEMENT.—If the State bank supervisor of a host State determines that a branch of an out-of-State insured State bank is violating any law of the host State that is applicable to such branch pursuant to section 24(j) of this Act, including a law that governs community reinvestment, fair lending, or consumer protection, the State bank supervisor of the host State or, to the extent authorized by the law of the host State, a host State law enforcement officer may, with written notice to the State bank supervisor of the bank's home State and subject to the terms of any applicable cooperative agreement with the State bank supervisor of the bank's home State, undertake such enforcement actions and proceedings as would be permitted under the law of the host State as if the branch were a bank chartered by that host State.

"(4) COOPERATIVE AGREEMENT.—The State bank supervisors from 2 or more States may enter into cooperative agreements to facilitate State regulatory supervision of State banks, including cooperative agreements relating to the coordination of examinations and joint participation in examinations. For purposes of this subsection (h), the term "cooperative agreement" means a written agreement that is signed by the home State bank supervisor and host State bank supervisor to facilitate State regulatory supervision of State banks and includes nationwide or multi-state cooperative agreements and cooperative agreements solely between the home State and host State. Except for State bank supervisors, no provision of this subsection (h) relating to such cooperative agreements shall be construed as limiting in any way the authority of home and host State law enforcement officers, regulatory supervisors, or other officials that have not signed such cooperative agreements to enforce host State laws that are applicable to a branch of an out-of-State insured State bank located in the host State pursuant to section 24(j) of this Act.

"(5) FEDERAL REGULATORY AUTHORITY.—No provision of this subsection shall be construed as limiting in any way the authority of any Federal banking agency.

"(6) STATE TAXATION AUTHORITY NOT AFFECTED.—No provision of this subsection (h) shall be construed as affecting the authority of any State or political subdivision of any State to adopt, apply, or administer any tax or method of taxation to any bank, bank holding company, or foreign bank, or any affiliate of any bank, bank holding company, or foreign bank, to the extent such tax or tax method is otherwise permissible by or under the Constitution of the United States or other Federal law.

"(7) DEFINITIONS.—For purpose of this section, the following definitions shall apply:

> "(A) The terms "host State", "home State", and "out-of-State bank" have the same meanings as in section 44(g).
>
> "(B) The term "State supervisory fees" means assessments, examination fees, branch fees, license fees, and all other fees that are levied or charged by a State bank supervisor directly upon an insured State bank or upon branches of an insured State bank.

"(C) Solely for purposes of subparagraph (2)(B) of this subsection (h), an insured State bank has been determined to be in "troubled condition" if the bank—

"(i) has a composite rating, as determined in its most recent report of examination, of 4 or 5 under the Uniform Financial Institutions Ratings System (UFIRS); or

"(ii) is subject to a proceeding initiated by the Corporation for termination or suspension of deposit insurance; or

(iii) is subject to a proceeding initiated by the State bank supervisor of the bank's home State to vacate, revoke, or terminate the charter of the bank, or to liquidate the bank, or to appoint a receiver for the bank.

"(D) For the purposes of paragraph (2)(B), the term 'final determination' means the transmittal of a Report of Examination to the bank or transmittal of official notice of proceedings to the bank.".

Explanation

This amendment would clarify home- and host-state authority for state-chartered banks operating on an interstate basis. It would reduce the regulatory burden on those banks by making clear that a chartering state bank supervisor is the principal state point of contact for safety and soundness supervision and how supervisory fees may be assessed.

Limits on Commercial Real Estate Loans

SEC. ___. COMMERCIAL REAL ESTATE LOANS—Section 5I(2)(B)(i) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(B)(i)) is amended by striking "400 percent of the Federal savings association's capital" and inserting "500 percent of the Federal savings association's capital (or such higher amount that the Director determines)".

Explanation

This section increases the limit on commercial real estate loans from 400 to 500 percent and permits the OTS to increase that amount. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility.

Loans to One Borrower

SEC. ___. LOANS TO ONE BORROWER—Section 5(u)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(u)(2)(A)) is amended by striking subclause (ii)(I).

Explanation

In addition to the loans-to-one borrower authority, savings associations may lend the lesser of $30 million or 30 percent of capital for a residential development. Within that overall limit, there is a $500,000 per-unit limit. This amendment eliminates a $500,000 per unit cap, while retaining the $30 million/30 percent limit. The per-unit cap is an excessive regulatory detail that creates an artificial market limit in high cost areas.

Home Office Citizenship

SEC.____. HOME OFFICE CITIZENSHIP—

(a) Federal Savings Associations --
Section 5 of the Home Owners' Loan Act (12 U.S.C. 1464) is amended by adding the following new subsection:

"(x) HOME STATE CITIZENSHIP- In determining whether a Federal court has diversity jurisdiction over a case in which a Federal savings association is a party, the Federal savings association shall be considered to be a citizen only of the State in which such savings association has its home office.".

(b) National Banks. – Chapter three of title LXII of the Revised Statutes of the United States (12 U.S.C. 81 et seq.) is amended by inserting after section 5190 the following new section:

"SEC. 5190A. STATE CITIZENSHIP. – In determining whether a Federal court has diversity jurisdiction over a case in which a national bank is a party, the national bank shall be considered to be a citizen only of the State in which such national bank maintains it main office.".

Explanation

This amendment provides that for purposes of jurisdiction in federal courts, a federal savings association is deemed to be a citizen of the State in which it has its home office. Federal law already provides that all national banks are deemed citizens of the states in which they are located for jurisdictional purposes. The second part of the amendment makes a similar clarification with respect to national banks.

Interstate Acquisitions

SEC. ___. INTERSTATE ACQUISITIONS-- Section 10(e)(3)of the Home Owners' Loan Act (12 U.S.C. 1467a(e)(3)) is amended by adding the following new subparagraph and redesignating the following subparagraphs accordingly:

"(A) such acquisition would be permissible for a bank holding company under section 3(d) of the Bank Holding Company Act of 1956;"

Explanation

This amendment permits a multiple savings association to acquire associations in other states under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

Application of QTL to Multi-State Operations

SEC. __. APPLICATION OF QUALIFIED THRIFT LENDER TEST ACROSS STATE LINES.

Section 5(r)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(r)(1)) is amended by striking the ultimate sentence.

Explanation

This section eliminates state-by-state application of the QTL test. This better reflects the business operations of savings associations operating in more that one state.

Applying International Lending Supervision Act to OTS

SEC. ____. -- BROADEN INTERNATIONAL LENDING SUPERVISION ACT OF 1983DEFINITION OF BANKING INSTITUTION TO APPLY TO THRIFTS.—

Subparagraph (A)(i) of section 903(2) of the International Lending Supervision Act of 1983 (12 U.S.C. 3902(2)) is amended to read as follows:

> "(A)(i) an insured depository institution as defined in section 3(c)(2) of the Federal Deposit Insurance Act or any subsidiary of an insured depository institution;".

Explanation

This provision would benefit OTS-regulated savings associations operating in foreign countries by assisting the OTS in becoming recognized as a consolidated supervisor.

OTS Representation on Basel Committee on Banking Supervision

SEC. __. OTS REPRESENTATION ON BASEL COMMITTEE ON BANKING SUPERVISION.—

(a) Section 912 of the International Lending Supervision Act of 1983 (12 U.S.C. 3911) is amended—

(1) by inserting at the end of the caption the following: "AND THE OFFICE OF THRIFT SUPERVISION";

(2) by striking "SEC. 912." And inserting "SEC. 912.(a)";

(3) in subsection (a), as designated by paragraph (2), by striking "three" and inserting "four"; and

(4) by inserting the following new subsection at the end:

"(b) As one of the four Federal bank regulatory and supervisory agencies, the Office of Thrift Supervision shall be given equal representation with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation on the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Switzerland.".

(b) CONFORMING AMENDMENTS.—Section 910(a) of such Act (12 U.S.C. 3909(a) is amended—

(1) in paragraph (2), by striking "insured bank" and inserting "insured depository institution"; and

(2) in paragraph (3), by striking "'insured bank', as such term is used in section 3(h)" and inserting "'insured depository institution', as such term is used in section (c)(2)".

Explanation

This provision adds the Office of Thrift Supervision to multi-agency committee that represents the United States before the Basel Committee on Banking Supervision. Savings institutions and other housing lenders would benefit by having the OTS perspective represented during the Basel committee's deliberations.

Parity for Savings Associations Acting as Agents for Affiliated Depository Institutions

SEC. ___. SAVINGS ASSOCIATIONS ACTING AS AGENTS —Section 18(r) of the Federal Deposit Insurance Act (12 U.S.C. 1828(r)) is amended by --

(1) in paragraph (1), striking "Any bank subsidiary of a bank holding company" and inserting "A depository institution of a depository institution holding company";

(2) (A) in the heading for paragraph (2), striking "BANK" and inserting "DEPOSITORY INSTITUTION"; and

(B) in paragraph (2), striking "bank" and inserting "depository institution";

(3) in paragraph (3), striking "or (6)" each time it appears; and

(4) in paragraph (5), striking "or (6)"; and

(5) striking paragraph (6) in its entirety.

Explanation

This section provides savings associations the same authority that banks have under section 18(r) of the Federal Deposit Insurance Act to act as agents for their affiliated depository institutions.

Inflation Adjustment for Depository Institution Management Interlocks

SEC. ___. AMENDMENT TO PROVIDE AN INFLATION ADJUSTMENT FOR THE SMALL DEPOSITORY INSTITUTION EXCEPTION UNDER THE DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT.

Section 203(1) of the Depository Institution Management Interlocks Act (12 U.S.C. 3202(1)) is amended by striking `$20,000,000' and inserting `$100,000,000'.

Explanation

The Depository Institutions Management Interlocks Act prohibits depository organizations from having interlocking management officials, if the depositories are located or have an affiliate located in the same metropolitan statistical area, primary metropolitan statistical area, or consolidated metropolitan statistical area. This statutory prohibition does not apply to depository organizations that have less than $20 million in assets. This section increases the exemption limit to $100 million in assets.

Reducing Debt-Collection Burdens

SEC. ___. CONTINUING COLLECTION EFFORTS – Section 809 of The Fair Debt Collection Practices Act (12 U.S.C. 1692g) is amended by adding the following new subsection and redesignating the following subsection accordingly:

> "(c) Continuing Collection Efforts. A debt collector may continue to collect the debt until the debt collector receives the notice described in subsection (b) of this section."

Explanation

A debtor has 30 days in which to dispute a debt. This amendment makes clear that a debt collector need not wait for that 30-day period while the debtor decides whether or not to dispute the debt.

Mortgage Servicing Clarification

SEC.__. MORTGAGE SERVICING CLARIFICATION.

(a) IN GENERAL- The Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.) is amended--

(1) by redesignating section 818 as section 819; and

(2) by inserting after section 817 the following new section:

`Sec. 818. Mortgage servicer exemption

`(a) EXEMPTION- A covered mortgage servicer who, whether by assignment, sale or transfer, becomes the person responsible for servicing federally related mortgage loans secured by first liens that include loans that were in default at the time such person became responsible for the servicing of such federally related mortgage loans shall be exempt from the requirements of section 807(11) in connection with the collection of any debt arising from such defaulted federally related mortgage loans.

`(b) DEFINITIONS- For purposes of this section, the following definitions shall apply:

`(1) COVERED MORTGAGE SERVICER- The term `covered mortgage servicer' means any servicer of federally related mortgage loans secured by first liens--

`(A) who is also debt collector; and

`(B) for whom the collection of delinquent debts is incidental to the servicer's primary function of servicing current federally related mortgagee loans.

`(2) FEDERALLY RELATED MORTGAGE LOAN- The term `federally related mortgage loan' has the meaning given to such term in section 3(1) of the Real Estate Settlement Procedures Act of 1974, except that, for purposes of this section, such term includes only loans secured by first liens.

`(3) PERSON- The term `person' has the meaning given to such term in section 3(5) of the Real Estate Settlement Procedures Act of 1974.

`(4) SERVICER; SERVICING- The terms `servicer' and `servicing' have the meanings given to such terms in section 6(i) of the Real Estate Settlement Procedures Act of 1974.'.

(b) CLERICAL AMENDMENT- The table of sections for the Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.) is amended--

(1) by redesignating the item relating to section 818 as section 819; and

(2) by inserting after the item relating to section 817 the following new item:

`818. Mortgage servicer exemption.'.

Explanation

This amendment incorporates H.R. 314, “The Mortgage Servicing Clarification Act,” which has broad industry and bipartisan support, passing the House by a vote of 424-0 last year. This legislation provides that servicers of loans do not have to provide the min-Miranda notices under the Fair Debt Collection Practices Act (FDCPA).

Repealing Overlapping Rules for Purchased Mortgage Servicing Rights

SEC. __. REPEAL OF OVERLAPPING RULES GOVERNING PURCHASED MORTGAGE SERVICING RIGHTS.

Section 5(t) of the Home Owners' Loan Act (12 U.S.C. 1464(t)) is amended--

(1) by striking paragraph (4) and inserting the following new paragraph: `(4) [Repealed]'; and

(2) in paragraph (9)(A), by striking `intangible assets, plus' and all that follows through the period at the end and inserting `intangible assets.'.

Explanation

The amendment eliminates the cap on valuation of purchased mortgage servicing rights at 90 percent of fair value and thereby permits savings associations to value purchased mortgage servicing rights, for purposes of certain capital and leverage requirements, at more than 90 percent of fair market value up to 100 percent, if banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions.

Loans to Executive Officers

SEC. 1. LOANS TO EXECUTIVE OFFICERS -- Section 22(g)(4) of the Federal Reserve Act (12 U.S.C. 375a(4)) is amended by striking "in an amount prescribed in regulation of the member bank's appropriate Federal banking agency" and inserting "up to the Member bank's limit on loans to one borrower".

SEC. 2. REPORTING REQUIREMENTS RELATING TO LOANS TO EXECUTIVE OFFICERS.

(a) REPORTING REQUIREMENTS REGARDING LOANS TO EXECUTIVE OFFICERS OF MEMBER BANKS- Section 22(g) of the Federal Reserve Act (12 U.S.C. 375a) is amended--

(1) by striking paragraphs (6) and (9); and
(2) by redesignating paragraphs (7), (8), and (10) as paragraphs (6), (7), and (8), respectively.

(b) REPORTING REQUIREMENTS REGARDING LOANS FROM CORRESPONDENT BANKS TO EXECUTIVE OFFICERS AND SHAREHOLDERS OF INSURED BANKS- Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(2)) is amended--

(1) by striking subparagraph (G); and
(2) by redesignating subparagraphs (H) and (I) as subparagraphs (G) and (H), respectively.

Explanation

Section 1 would eliminate the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loan, i.e., those other than housing, education, and certain secured loans. This conforms the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit.

Section 2 eliminates certain reporting requirements currently imposed on banks and their executive officers and principal shareholders related to lending by banks to insiders. The change in reporting requirements would not alter restrictions on the ability of banks to make insider loans or limit the ability of federal banking agencies to take enforcement action against a bank or its insiders for violation of lending limits.

Decriminalizing RESPA

SEC. ___. ELIMINATION OF IMPRISONMENT SANCTION – Section 8(d)(1) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2607(d)(1)) is amended by striking "or imprisoned for not more than one year, or both".

Explanation

This strikes the imprisonment sanction for violations of RESPA. The possibility of a $10,000 fine remains, maintaining adequate deterrence.

Bank Service Company Investments

SEC. ___. INVESTMENTS IN SERVICE COMPANIES.

(a) BANK SERVICE COMPANIES.

(1) INVESTMENTS BY OTHER INSURED DEPOSITORY INSTITUTIONS IN BANK SERVICE COMPANIES AUTHORIZED.— Subparagraphs (A)(ii) and (B)(ii) of section 1(b)(2) of the Bank Service Company Act (12 U.S.C. 1861(b)(2)) are each amended by striking "insured banks" and inserting "insured depository institutions, as defined in section 3 of the Federal Deposit Insurance Act".

(2) TECHNICAL AMENDMENTS.—Section 1(b)(4) of such Act (12 U.S.C. 1861(b)(4)) is amended—

(A) by striking "Federal Home Loan Bank Board" and inserting "Director of the Office of Thrift Supervision"; and

(B) by striking ", the Federal Savings and Loan Insurance Corporation,".

(b) INVESTMENT BY OTHER INSURED DEPOSITORY INSTITUTIONS IN THRIFT SERVICE COMPANIES AUTHORIZED.—The first sentence of section 5(c)(4)(B) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) is amended by striking "by savings associations of such State and by Federal associations" and inserting "by insured depository institutions, as defined in section 3 of the Federal Deposit Insurance Act,".

Explanation

The Bank Service Company Act permits national and state banks to invest in companies that may provide clerical, administrative and other services closely related to banking to depository institutions. This section amends the BSC Act and Home Owners' Loan Act to provide parallel investment ability for banks and thrifts to participate in both BSCs and thrift service corporations. It preserves existing activity limits and maximum investment rules and makes no change in the roles of the federal regulatory agencies with respect to subsidiary activities of the institutions under their primary jurisdiction. Federal thrifts thus would need to apply only to OTS to invest.

Note: Section 406 of HR 1375 also would permit thrifts to invest in BSCs, but would not allow a bank to invest in a thrift service corporation and would subject a thrift investor in a BSC to an additional regulator, the Federal Reserve. While Sec. 406 addresses the needs of thrifts seeking to invest in a BSC, it brings potential new regulatory burdens and is asymmetrical because it does not provide parallel treatment for banks.

Eliminating Savings Association Service Company Geographic Restrictions

SEC. ___. ELIMINATING GEOGRAPHIC LIMITS ON SAVINGS ASSOCIATION SERVICE COMPANIES.

(a) IN GENERAL- The 1st sentence of section 5(c)(4)(B) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) (as amended by section 406(b)(3) of this Act) is amended--

(1) by striking `corporation organized' and all that follows through `is available for purchase' and inserting `company, if the entire capital of the company is available for purchase'; and

(2) by striking `having their home offices in such State'.

(b) TECHNICAL CORRECTIONS-

(1) The heading for subparagraph (B) of section 5(c)(4) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) is amended by striking `CORPORATIONS' and inserting `COMPANIES'.

(2) The 2nd sentence of section 5(n)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(n)(1)) is amended by striking `service corporations' and inserting `service companies'.

(3) Section 5(q)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(q)(1)) is amended by striking `service corporation' each place such term appears in subparagraphs (A), (B), and (C) and inserting `service company'.

(4) Section 10(m)(4)(C)(iii)(II) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(4)(C)(iii)(II)) is amended by striking `service corporation' each place such term appears and inserting `service company'.

Explanation

Permits federal savings associations to invest in service companies without regard to geographic restrictions.

Streamlining Subsidiary Notifications

SEC. ___. STREAMLINING SUBSIDIARY NOTIFICATIONS—Section 18(m)(1)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)(1)(A)) is amended by striking “the Corporation and” and by striking “each such agency” and inserting “the Director of the Office of Thrift Supervision”.

Explanation

This amendment eliminates the requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. A savings association will still be required to notify the OTS, providing sufficient regulatory oversight.

Authorizing Additional Community Development Activities

SEC. ___. INVESTMENTS BY FEDERAL SAVINGS ASSOCIATIONS AUTHORIZED TO PROMOTE THE PUBLIC WELFARE.

(a) IN GENERAL- Section 5(c)(3) of the Home Owners' Loan Act (12 U.S.C. 1464(c)) is amended by adding at the end the following new subparagraph:

`(E) DIRECT INVESTMENTS TO PROMOTE THE PUBLIC WELFARE-

`(i) IN GENERAL- A Federal savings association may make investments designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families through the provision of housing, services, and jobs.

`(ii) DIRECT INVESTMENTS OR ACQUISITION OF INTEREST IN OTHER COMPANIES- Investments under clause (i) may be made directly or by purchasing interests in an entity primarily engaged in making such investments.

`(iii) PROHIBITION ON UNLIMITED LIABILITY- No investment may be made under this subparagraph which would subject a Federal savings association to unlimited liability to any person.

`(iv) SINGLE INVESTMENT LIMITATION TO BE ESTABLISHED BY DIRECTOR- Subject to clauses (v) and (vi), the Director shall establish, by order or regulation, limits on--

`(I) the amount any savings association may invest in any 1 project; and
`(II) the aggregate amount of investment of any savings association under this subparagraph.

`(v) FLEXIBLE AGGREGATE INVESTMENT LIMITATION- The aggregate amount of investments of any savings association under this subparagraph may not exceed an amount equal to the sum of 5 percent of the savings association's capital stock actually paid in and unimpaired and 5 percent of the savings association's unimpaired surplus, unless--

`(I) the Director determines that the savings association is adequately capitalized; and

`(II) the Federal Deposit Insurance Corporation determines, by order, that the aggregate amount of investments in a higher amount than the limit under this clause will pose no significant risk to the affected deposit insurance fund.

`(vi) MAXIMUM AGGREGATE INVESTMENT LIMITATION- Notwithstanding clause (v), the aggregate amount of investments of any savings association under this subparagraph may not exceed an amount equal to the sum of 10 percent of the savings association's capital stock actually paid in and unimpaired and 10 percent of the savings association's unimpaired surplus.

`(vii) INVESTMENTS NOT SUBJECT TO OTHER LIMITATION ON QUALITY OF INVESTMENTS- No obligation a Federal savings association acquires or retains under this subparagraph shall be taken into account for purposes of the limitation contained in section 28(d) of the Federal Deposit Insurance Act on the acquisition and retention of any corporate debt security not of investment grade.'.

(b) TECHNICAL AND CONFORMING AMENDMENT- Section 5(c)(3)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(3)(A)) is amended to read as follows:

`(A) [Repealed.]'.

Explanation

This amendment permits Federal savings associations to make community development investments to the same extent permitted for national banks.

Eliminating Dividend Notice Requirements

SEC. ___. DIVIDEND NOTICES-- Section 10(f) of the Home Owners' Loan Act (12 U.S.C. 1467a(f)) is amended by adding the following paragraph and redesignating section 10(f) as section 10(f)(1):

> "(2) this subsection shall not apply to a subsidiary savings association that is well capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) and will remain well capitalized after the payment of the dividend."

Explanation

Under this amendment, well-capitalized savings associations in savings and loan holding companies will no longer be required to notify the OTS of their intention to pay a dividend, provided that they will remain well capitalized after they pay the dividend. This will allow well-capitalized institutions to conduct routine business without regularly conferring with the OTS.

Reimbursement for the Production of Records

SEC. ___. CORPORATE RECORDS—Section 1101(4) of the Right to Financial Privacy Act (12 U.S.C. 3401(4)) is amended by adding ", except that such term shall mean any legal entity for purposes of section 1115 of this Act" after "individuals".

SEC. ___. CLARIFICATION OF SCOPE—Section 1115 of the Right to Financial Privacy Act is amended by adding the following new sentence—

> "This section shall apply to records required to be assembled or provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001."

Explanation

The Right to Financial Privacy Act provides that the government will reimburse banks for the cost of assembling and providing records of individual bank customers that the government is investigating. This amendment extends that to records of corporate bank customers. The amendment also clarifies that RFPA reimbursement requirements apply to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.

Extending Divestiture Period

SEC. ___. EXTENDING DIVESTITURE PERIOD—Section 10(c)(1)(C) of the Home Owners' Loan Act (12 U.S.C. 1467a(c) (1)(C)) is amended by striking "2-year period" and inserting "10-year period".

Explanation

This amendment provides unitary savings association holding companies that become multiple savings association holding companies have 10 years to divest non-conforming activities. This is the same period granted to new financial services holding companies under the Gramm-Leach-Bliley Act.

Restrictions on Auto Loans

SEC.__. REMOVAL OF LIMITATION ON INVESTMENTS IN AUTO LOANS.

(a) IN GENERAL- Section 5(c)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(1)) is amended by adding at the end the following new subparagraph:

`(V) AUTO LOANS- Loans and leases for motor vehicles acquired for personal, family, or household purposes.'.

(b) TECHNICAL AND CONFORMING AMENDMENT RELATING TO QUALIFIED THRIFT INVESTMENTS- Section 10(m)(4)(C)(ii) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(4)(C)(ii)) is amended by adding at the end the following new subclause:

`(VIII) Loans and leases for motor vehicles acquired for personal, family, or household purposes.'.

Explanation

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. The amendment removes this restriction and expands consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

Credit Card Savings Associations

SEC.___. AMENDMENT TO SECTION 10 OF THE HOME OWNERS" LOAN ACT.

Section 10(a)(1)(A) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(A)) is amended by inserting the following new sentence at the end: "The term 'savings association' does not include an institution described in section 2(c)(2)(F) of the Bank Holding Company Act of 1956 for purposes of subsections (a)(1)(E), (c)(3)(B)(i), (c)(9)(C)(i), and (e)(3).".

Explanation

Under current law, a savings and loan holding company cannot own a credit card savings association and still be exempt from the activity restrictions imposed on companies that control multiple thrifts. However, a savings and loan holding company could charter a credit card institution as a national or state bank and still be exempt from the activity restrictions imposed on multiple savings and loan holding companies. This proposal amends the Home Owners' Loan Act to permit a savings and loan holding company to charter a credit card savings association and still maintain its exempt status. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.

Protection of Information Provided to Banking Agencies

SEC. ___. PRIVILEGES NOT WAIVED BY DISCLOSURE TO BANKING AGENCY.

Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end the following new subsection:

> "(x) PRIVILEGES NOT WAIVED BY DISCLOSURE TO BANKING AGENCY. The submission by a depository institution of any information to a Federal banking agency, a State bank supervisor, or a foreign banking authority for any purpose in the course of the supervisory process of such agency or supervisor shall not be construed as waiving, destroying, or otherwise affecting any privilege such institution may claim with respect to such information under Federal or State law.".

Explanation

> This amendment provides that when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors.

Appendix B

to

America's Community Bankers'

Testimony

on

Financial Services Regulatory Relief: Private Sector Perspectives

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

of the

United States House of Representatives

on

May 19, 2005

May 6, 2005

Ms. Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Attention: Docket No. OP-1220

Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington D.C. 20219

Attention: Docket No. 05-01

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington D.C. 20552

Attention: No. 2005-02

Re: Request for Burden Reduction Recommendations; Money Laundering, Safety and Soundness, and Securities Rules; Economic Growth and Regulatory Paperwork Reduction Act of 1996 Review
70 FR 5571 (February 3, 2005)

Dear Sir or Madam:

America's Community Bankers (ACB)[1] is pleased to comment on the federal banking agencies' (the agencies)[2] review of regulatory burden imposed on insured depository institutions.[3] Required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),[4] the agencies are reviewing and identifying outdated, unnecessary, and unduly burdensome regulatory requirements. This comment letter responds to the request for comments regarding money laundering, safety and soundness, and securities rules.

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[1] America's Community Bankers is the national trade association partner for community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

[2] Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve Board (the "Board"), Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

[3] 70 Fed. Reg. 5571 (February 3, 2005).

[4] Pub. L. 104-208, Sept. 30, 1996.

ACB Position

ACB strongly supports the agencies in their ongoing efforts to reduce the regulatory burden on insured depository institutions. Generally, the statutes enacted and the required implementing regulations serve a very useful purpose by themselves, but when layered upon the existing requirements, community banks frequently must comply with overlapping and voluminous regulations. Several of the regulations that are the subject of this request for comment are among those that community bankers raise as the being the most burdensome. We welcome the scrutiny of the agencies on these regulations and we hope that this review results in changes that relieve some of the regulatory burden while preserving the benefits of the requirements.

Anti-money laundering regulations

The anti-money laundering statutes and the implementing regulations were adopted with the best of intentions. The Bank Secrecy Act (BSA) was enacted in 1970 and one of the primary goals was to eliminate or mitigate the laundering of the profits of drug trafficking and other illicit businesses. The USA Patriot Act was enacted to root out terrorists, ensure the safety of the American people, and protect the integrity of the U.S. financial system. ACB supports the goals of these laws, however, inconsistent interpretation of the implementing regulations by examiners and a lack of regulatory guidance have made it increasingly difficult for community banks to comply with anti-money laundering demands and have produced a plethora of unintended consequences.

ACB offers the following suggestions to improve BSA oversight.

Consistent Implementation

Community banks are frustrated by the conflicting messages conveyed by banking regulators. Washington officials repeatedly assure the industry that the banking agencies do not have "zero tolerance" for anti-money laundering deficiencies. Nevertheless, regional offices and individual examiners continue to use this language when conducting BSA examinations and when making presentations during industry conferences. ACB is very pleased that Washington acknowledges that perfect compliance is impossible. We urge the agencies to ensure that all regional offices and examiners understand and adhere to this fundamental principle of regulatory policy.

ACB hopes that the anticipated interagency examination procedures will clarify the regulators' compliance expectations and will provide consistency across and within the agencies. It is important that institutions understand what is expected of them, yet many community banks believe that there are no pre-established standards against which their compliance efforts will be evaluated. Accordingly, we urge the agencies to make every effort to ensure that the examination procedures are made available by June 30, 2005, as promised.

Suspicious Activity Reporting

Examination for compliance with suspicious activity reporting requirements is one specific area where we ask the regulators to be more consistent and provide additional guidance.

Defensive SARs. The federal banking agencies are scrutinizing suspicious activity reporting more closely than ever and anxiety over whether an institution should file a SAR is at an all-time high. As a result, many depository institutions believe that filing more SARs is the key to avoiding regulatory criticism. Many institutions file SARs as a defensive tactic to stave off "second guessing" of an institution's suspicious activity determinations. This mindset is fueled by examiners who criticize institutions for not filing enough SARs based on their asset size. Furthermore, regulators have admitted in public fora that the agencies do not discourage the "when in doubt, fill it out" strategy.[5] Finally, enforcement actions in the past year appear to confirm the idea that it is better to have filed a SAR when it is not necessary than to have not filed one.

It is more time consuming and paperwork intensive for an institution to document why it elected not to file a SAR than to simply file the report. Institutions believe that the risk of regulatory criticism is higher for not filing and that examiners will disapprove of the bank's documentation or its decision not to file.

While institutions feel pressure to file more SARs by their primary regulator, FinCEN director William Fox has warned that the value of SAR data will be less valuable and that the integrity and usefulness of the SAR system will be compromised by the onslaught of "defensive" SARs. In March 2005, financial institutions submitted nearly 43,500 SARs, up 40 percent from March 2004. Director Fox recently wrote in the April 2005 *SAR Activity Review*, "these 'defensive filings' populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns."

The problem of defensive SAR filing is further exacerbated by recent deferred prosecution agreements between the Department of Justice and financial institutions whose SAR reporting programs have been deemed deficient.

In this era of increased regulatory scrutiny, community banks deserve more guidance and information. ACB strongly urges the regulators to work with FinCEN and the Department of Justice to articulate a single, clear policy on suspicious activity reporting that is applied consistently. It is critical that this policy be made clear to the regional offices, bank examiners and officials of the Department of Justice across the country.

[5] While most industry feedback indicates that community banks feel pressured to file larger quantities of SARs, some institutions have been cautioned by their regulators against such liberal filing. This approach, too is frustrating.

Further, we do not believe that insured institutions should be placed in the middle of a harsher enforcement regime when the federal agencies attempt to satisfy their Inspectors General. Rather, the banking regulators, FinCEN, and the Department of Justice should work to help institutions identify activities that are genuinely suspicious and should be reported. We are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment. The current state of affairs is not the best use of the time and resources of all parties involved and is not helping to enhance the security of our country.

SAR Guidance. On December 23, 2004, ACB requested that FinCEN provide updated, centralized SAR reporting guidance (See Attachment A). In a response from FinCEN dated April 22, 2005, we have been assured that many of the points raised are being addressed. We welcome the changes and urge the agencies to work with FinCEN to ensure rapid dissemination of any changes and guidance. ACB continues to believe that not understanding what constitutes suspicious behavior continues to be one of the most burdensome aspects of BSA compliance. Accordingly, we urge the agencies to work with FinCEN to compile a comprehensive guide to SAR filing that includes:

- A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity is indicative of terrorist finance?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question also is important in helping to separate those occurrences that should not be reported. We also encourage the agencies and FinCEN to include examples or case studies where SARs are or are not warranted.
- Centralized Guidance. Over the years, FinCEN and the federal banking agencies have produced helpful guidance, interpretations, and answers to frequently asked questions. While this information is useful, it has not been compiled in a centralized location. Accordingly, we ask the agencies to work with FinCEN to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:
    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money*

Laundering: A Banker's Guide to Avoiding Problems (December 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

Account Monitoring Software. Increasing numbers of community banks have been instructed by their examiners to purchase account monitoring software to help identify suspicious activity. However, it is unclear at what point the regulators will expect institutions to install such software. Some institutions have been told that in certain geographic locations, institutions with more than $250 million in assets are "strongly encouraged" to implement an account/customer monitoring software system. Representatives from the federal banking agencies have told ACB that they do not intend to identify the circumstances under which institutions will be expected to install such monitoring software.

We thoroughly agree that a one-size fits all approach is not appropriate. However, it would be very helpful for the agencies to elaborate on the circumstances under which such account monitoring systems should be considered. The cost of purchasing these systems is significant, and helping community banks to better understand when such systems will be required will enable institutions to better budget and plan for this large expense. Account monitoring software packages used by community banks often cost between $30,000 and $50,000 (and sometimes much more), plus a $5,000 per month service charge or maintenance fee. In many cases, institutions must hire additional personnel or take existing staff away from other bank responsibilities to run the software, review flagged accounts, and file SARs when necessary.

Some community banks have been instructed to use their account monitoring software to drill down to the fourth level of an account relationship (i.e. the fourth person listed on a signature card) to study tax identification numbers, names, and addresses for suspicious information. Many institutions report that they have difficulty making those correlations on the second level, let alone the fourth. We believe that the agencies are working with law enforcement to determine how money launderers adjust their techniques and are asking the industry to adjust its account monitoring processes accordingly.

<u>Characterization of BSA Violations</u>

ACB believes that BSA enforcement should be consistent, particularly with regard to whether BSA violations are characterized as "program violations" or "FinCEN violations." The federal banking agencies have indicated that compliance problems identified as "program violations" will result in an automatic written supervisory agreement with the institution, while problems classified as "FinCEN violations" will be addressed more informally.

The characterization of an institution's BSA violations has strong repercussions beyond the formality with which problems will be addressed. The characterization of compliance problems as "program violations" may affect the institution's CAMELS rating, its ability to merge with or purchase other institutions, build or acquire new branches or expand into new product lines. For publicly traded banks, a written, formal agreement may also warrant disclosure in filings with the Securities and Exchange Commission. Because the

characterization of BSA violations has such a significant impact on the institution, ACB urges the banking agencies to emphasize the importance of this matter when training and updating their examiners.

We have heard a number of examination experiences that provide useful examples. One community bank that recently underwent a BSA compliance exam was cited by its examiners for failure to identify a local business as an money service business (MSB) and failure to file a suspicious activity report on that same business. The institution is well-capitalized and well managed and filed approximately 4,500 SARs last year. The report of examination devoted one paragraph to BSA issues and the institution took the required corrective actions, believing the matter to be closed. Over six months later, the institution's regional regulator re-characterized the violations as "program violations" and presented the bank with a written supervisory agreement. The bank ultimately persuaded the regional office to address the matter less formally, but the process remains unclear and too subjective.

It is imperative that examiners and regional offices understand how classifying violations as one form or another affects an institution. We urge the regulators to work to ensure that such characterizations are applied correctly, consistently, and in a timely manner.

Money Services Businesses

The provision of banking services to MSBs and an institution's corresponding regulatory requirements have been widely discussed within the banking industry in recent months. ACB believes that the issues underlying the supervision of depository institutions that provide banking services to MSB's are an extension of larger problems that permeate the entire BSA oversight mechanism.

MSB's play an important role in providing financial products and services to persons that do not have a traditional banking relationship with a depository institution. Many small businesses that are now dubbed MSBs have been good customers for community banks. Grocery stores, truck stops, and even feedstores are examples of the types of businesses that now fall within the category of MSBs because they cash checks in excess of $1,000 per person per day.

For example, depository institutions have been pressured by examiners to close accounts of long-time customers that may be considered to be a "money service business." Other institutions believe that the due diligence requirements for these accounts outweigh the benefit of having MSBs as customers. Many institutions are unwilling to take on the compliance risk now associated with MSB accounts. Others do not believe that they have an adequate understanding of what constitutes unusual activity for MSBs in general and have indicated that they will not bank MSB customers until they have more direction from FinCEN and the banking regulators.

On March 8, 2005, ACB was pleased to participate in the joint meeting of the Non-bank Financial Institutions and Examinations Subcommittee of the Bank Secrecy Act Advisory

Group to discuss the provision of banking services to MSBs. This meeting explored why financial institutions large and small closed the accounts of their MSB customers. We believe that the meeting helped underscore the need for regulatory guidance and consistent interpretation of enhanced due diligence requirements for depository institutions that have MSB customers.

ACB also is very appreciative of the March 30, 2005 joint statement issued by the federal banking agencies and FinCEN clarifying that depository institutions are not expected to serve as a *de facto* regulator of the money services business industry. Notwithstanding the important policy positions articulated in the joint release, community banks are not re-opening accounts for MSBs in wide numbers. Furthermore, institutions continue to have varying interpretations of the regulatory requirements associated with banking MSBs.

We believe that this problem will be remedied by the joint guidance issued by FinCEN and the banking agencies on April 26, 2005. ACB is very encouraged that the agencies and FinCEN acted on requests for guidance and explained the different kinds of risks and appropriate due diligence required for MSB accounts. We also appreciate the examples of suspicious activity that the guidance provides. We hope that the guidance will help examiners evaluate the banking industry's monitoring of MSB accounts more consistently.

While the guidance on appropriate monitoring of MSB accounts is welcome, we believe that additional compliance questions should be addressed. Namely, how financial institutions should treat those businesses that engage in "MSB activity" in rare circumstances.

For example, a community bank reported that local farmers sometimes take on odd jobs to earn extra money. On occasion, a farmer will endorse his paycheck over to the local feedstore in exchange for goods. An examiner that interpreted the MSB requirements narrowly believed that the feedstore should be treated as an MSB. However, we do not believe that it is reasonable to require the feedstore to register as an MSB, nor is it appropriate to require a financial institution to monitor the account as such. Accordingly, we request the banking agencies to work with FinCEN to identify situations that are exempt or should be exempt from the MSB requirements.

We also encourage the regulators to help institutions recognize unidentified MSBs. Community banks are very concerned that they are unknowingly providing banking services to customers that are operating as MSBs and worry that they will face regulatory criticism for failing to identify these accounts. ACB requests the federal banking agencies to provide guidance on transaction patterns and other indicia of common MSB account activity. This information would help community banks identify business customers that qualify as MSBs and inform them of the associated registration and compliance requirements. In many cases, businesses do not know what an MSB is, much less that there are regulatory requirements for engaging in this activity.

Finally, community banks are concerned about allegations of discrimination in connection with MSB accounts. Institutions have deemed some MSBs to pose a higher risk of money

laundering than others. In many cases, banks are not equipped to monitor high-risk MSB accounts properly and have terminated these account relationships. Institutions worry that they will be accused of discriminatory practices for maintaining some MSB accounts but not others. Reputation risk in the community is a very real concern to community banks.

OFAC

The prohibition against processing transactions for persons and entities designated by the Office of Foreign Assets Control (OFAC) is not new. However, renewed focus on anti-money laundering efforts has raised many questions regarding an institution's obligations in this area.

OFAC simply prohibits financial institutions from processing a transaction for persons and entities on the OFAC list and institutes a strict liability standard for non-compliance that will result in monetary penalties. This broad standard does not address many practical questions that community banks have about OFAC compliance. For example, what is an institution's obligation regarding checking automated clearing house transactions? Are obligations different for originating or receiving institutions? ACB has heard that the Federal Reserve Board is considering implementing a program that may screen all ACH items and wire transfers against the OFAC list. While there would be many unanswered questions regarding how any "hits" would be addressed and who would have the obligation to freeze a transaction, we believe that Federal Reserve screening of ACH payments would provide valuable regulatory relief to community banks. ACB urges the Federal Reserve to seriously consider this option.

Community banks also ask how frequently they should check their customer base against the OFAC list or how soon they should check the OFAC list when presented with certain transactions. We understand that the agencies view these decisions as being "risk-based," but community banks need help understanding what the risk factors are. In addition, it would be instructive for the agencies to articulate their approach in the event an institution processes a transaction involving a person or entity on the OFAC list. U.S. banks process millions of financial transactions each day, and it is impossible to screen all interested parties against the OFAC list. Inevitably, some prohibited transactions will be processed. ACB requests the agencies to specify that they will not take regulatory action independent of OFAC sanctions.

ACB is pleased that the banking agencies and FinCEN have been able to work with OFAC to determine that, as a general matter, SAR requirements will be satisfied if an institution files a blocking report with OFAC in accordance with OFAC's Reporting, Penalties, and Procedures Regulations. OFAC will then provide the information to FinCEN for inclusion in the SAR reporting database, where it will be made available to law enforcement. The filing of a blocking report with OFAC, however, will not satisfy an institution's obligation to identify and report suspicious activity beyond the fact of an OFAC match. ACB believes that this clarification provides meaningful regulatory relief for community banks by eliminating what is essentially a duplicative reporting requirement to the U.S. Department of the Treasury.

Currency Transaction Reports

FinCEN regulations require financial institutions to file currency transaction reports for all cash transactions over $10,000.[6] FinCEN's regulations establish an exemption system that relieves financial institutions from filing CTRs on the cash transactions of certain entities, provided certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance. The exemption process was well intentioned, but community banks have been reluctant to use the exemption system because:

- It is not cost effective for small institutions that do not file many CTRs.
- They fear regulatory action in the event that an exemption is used incorrectly.
- They lack the time to conduct the research necessary to determine whether a customer is eligible for an exemption.
- It is easier to automate the process and file a CTR on every transaction that triggers a reporting requirement.
- The regulations and the exemption procedures and requirements are overly complex.

As a result, financial institutions have filed over 12 million CTRs each year since 1995.[7] FinCEN and law enforcement report that the CTR database is littered with unhelpful CTRs because financial institutions do not use the exemption procedures that are designed to eliminate CTRs that are of no interest to law enforcement. As a result, it is more difficult to use the database to investigate possible cases of money laundering or terrorist finance.

ACB believes that currency transaction reporting requirements are ripe for review. We suggest the following reforms to ease regulatory burden on financial institutions and improve the utility of the CTR database for law enforcement.

CTR Reporting Threshold. ACB strongly supports raising the dollar value that triggers CTR filing. Increasing the reporting requirement would dramatically decrease the number of CTRs that are filed each year and would provide much needed relief from BSA regulatory burden.

An update of the CTR regulations is long overdue because the current rules have not kept pace with the economy. Since 1970, institutions have been required to file CTRs on cash transactions over $10,000. When adjusted for inflation, $10,000 in 1970 is equivalent to $50,335 today. [8] We have heard that when the regulations were first implemented, there was very little activity over the $10,000 threshold. Today, however, such transactions are routine, particularly for cash intensive businesses.

[6] 31 CFR 103.22(b)(1).
[7] FinCEN Report to Congress, *Use of Currency Transaction Reports* (October 2002).
[8] Federal Reserve Bank of Minneapolis inflation calculator.
http://woodrow.mpls.frb.fed.us/research/data/us/calc/

Based upon data that FinCEN provided to the Bank Secrecy Act Advisory Group's ("BSAAG") CTR Subcommittee, increasing the reporting threshold to $20,000 would decrease CTR filings by 57 percent and increasing the threshold to $30,000 would decrease filings by 74 percent.[9] The impact of raising the dollar value is even more astonishing for community banks. An informal survey of ACB members conducted in June 2004 indicates that increasing the dollar amount to $20,000 would reduce community bank CTR filings by approximately 80 percent. Even with the dramatic change in the value of $10,000 over the past thirty years, ACB acknowledges that a $10,000 cash transaction is still a substantial amount of cash for an individual customer to deposit or withdraw from an institution. However, businesses of all sizes routinely conduct transactions over $10,000.

Some law enforcement officials strongly oppose adjusting the dollar value that triggers CTR reporting out of a concern that doing so would decrease the amount of data that could potentially assist in a future criminal investigation. As a practical matter, the 30-year old CTR filing requirements need to be updated to reflect today's economic reality. We believe that updating the regulations would help, not hinder the investigatory process. The reduction in the number of CTR filings would meet the Congressional mandate to reduce CTR filings by 30 percent, as required by the Money Laundering Suppression Act of 1994. More importantly, users of CTR data would benefit from a cleaner, more efficient CTR database. Raising the threshold does not mean that institutions will be relieved from monitoring account activity for suspicious transactions below the CTR reporting requirement. Increasing the threshold would enable financial institutions to alert law enforcement about activity that is truly suspicious or indicative of money laundering, as opposed to bogging down the data mining process by filing reports on routine business transactions.

Exemption System. A discussion of solutions to reduce the number of CTR filings would not be complete without addressing the exemption system that relieves financial institutions from filing CTRs on certain entities.[10] While the exemption scheme was designed to minimize the

[9] FinCEN. *CTRs Posted By Amount Range,* (2004).

[10] Pursuant to the Money Laundering Suppression Act, FinCEN established two categories of transactions that are exempt from CTR reporting. Phase I exemptions (31 CFR 103.22 (d)(2)(i)-(v)) apply to banks, government agencies, government instrumentalities, publicly traded businesses (referred to in the regulations as a "listed business") and certain subsidiaries of publicly traded businesses. A business that does not fall into any of the above categories may still be exempted under the Phase II exemptions (31 CFR 103.22 (d) (2) (vi)-(vii)) if it qualifies as either a "non-listed business" or as a "payroll customer." The new rules also established specific procedures for exempting eligible customers. In determining whether to exempt a customer, a depository institution must document such steps a reasonable and prudent institution would take to protect itself from loan or other fraud or loss based on misidentification of a person's status. The institution must document the basis for its decision to exempt a customer from currency transaction reporting and maintain such documents for five years. After an institution has decided to exempt a customer, the bank must file a Designation of Exempt Person form within 30 days after the first customer transaction the

number of CTRs that institutions file, community banks have reported that the cost of using the exemptions outweighs any associated benefits.

The exemption requirements are particularly challenging for community bankers that perform multiple functions within an institution and simply do not have the time to study the requirements and apply them to specific customers. In addition, institutions are reluctant to use the exemptions for fear of applying the rules incorrectly. As a result, many community banks have elected to automate the CTR reporting process and file on every transaction over $10,000.

There has been discussion in the financial community about providing interpretive guidance that provides examples and explains how to apply the rules. While guidance would be helpful, we do not believe that it would lead to a significant reduction in CTR filings. Even if guidance is issued, most community banks that have elected not to use the exemption process will continue to file on all cash transactions over $10,000. This compliance method is cost effective and exposes institutions to minimal compliance risk.

While many community banks do not use the exemption process, those that do would like to exempt customers more quickly than currently permitted by regulation. Before an institution can exempt a customer as a non-listed business or payroll customer, the customer must have maintained a transaction account with the bank for at least twelve months.[11] The 12-month rule was adopted to ensure that an institution is familiar with a customer's currency transactions.

ACB encourages the agencies to work with FinCEN to allow institutions to more quickly exempt business customers. Recent regulations implementing the Patriot Act allow institutions to make risk-based decisions about their anti-money laundering efforts. Likewise, FinCEN should give institutions greater discretion in determining when to exempt a business customer from CTR reporting. A community bank, not a regulatory agency, is in the best position to determine whether it is sufficiently familiar with a customer's account activity. While allowing institutions to take a risk-based approach would not significantly reduce CTR filings, it would provide regulatory relief to those institutions that elect to use the exemption process.

Compliance Costs

Depository institutions are pillars of their communities and are an important part of the larger U.S. economy. As such, community banks are committed to ensuring our nation's physical

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institution wishes to exempt. For Phase I customers, the form has to be filed only once (though the institution must annually review the customer's status). For Phase II customers, the form must be refiled every two years as part of the biennial renewal process. As with Phase I customers, the bank must also annually review the status of Phase II customers.

[11] 31 C.F.R. 103.22(d)(2)(vi)(A), (d)(2)(vii)(A).

security and the integrity of our financial system. BSA compliance costs have skyrocketed since the Patriot Act was signed into law. Increasingly, financial institutions believe that the federal government has little regard for the amount of time, personnel, and monetary resources that BSA compliance drains from a institution's ability to serve its community.

As mentioned earlier, institutions that purchase account monitoring software to flag suspicious transactions or other unusual circumstances easily costs $30,000 (and sometimes hundreds of thousands of dollars) upfront and $5,000 each month thereafter. Sometimes, institutions hire new personnel just to study the "red flags" identified by the software to determine if the flagged activity warrants a SAR filing. Furthermore, community banks commonly spend an initial $5,000 plus transaction fees to access identity "verification" databases to help satisfy the Patriot Act's customer identification requirements.

To put these figures into context, the monthly fee for suspicious activity monitoring software is money that an institution could have spent to hire multiple tellers, hire a new loan officer to reach out to the community's small businesses, or develop and market a new product. What may seem like insignificant costs to lawmakers in Washington have very real business implications for community banks and their communities.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers. In recent months, waves of depository institutions severed ties with MSB customers due to pressure from examiners, regulatory uncertainty, or simply being overwhelmed by regulatory requirements associated with these accounts. Community banks have also opted not to open accounts for non-resident aliens and other persons out of fear that the institution will not be able to meet the "reasonable belief" standard established in the customer identification requirements. While many institutions accept the matricula consular as a form of identification, others have taken a cautious approach to compliance and have elected not to accept the card. As a result, come community banks forego opportunities to establish banking relationships with the unbanked and promote financial literacy among this segment of the population – all because of concerns that the bank will not be able to satisfy regulatory requirements.

Reporting Requirements Under the Securities Exchange Act of 1934

The Sarbanes-Oxley Act of 2002 (SOX) significantly increased the burden of reporting under the Securities Exchange Act of 1934 for all public companies, but particularly for community banks. Much of that burden was imposed by the Securities and Exchange Commission (SEC) in implementing regulations. We believe that the SEC has issued final rules that include expanded the reporting requirements that go beyond what was required by SOX. ACB understands that many of the regulations addressed in this section of the letter have been promulgated by the SEC and that the agencies incorporate these regulations by reference into

their regulations. We strongly urge the agencies to work with the SEC to minimize the reporting burden for community banks.

Two areas of great concern are internal control requirements under section 404 of SOX and the acceleration of filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and beneficial ownership reports under Section 16 of the Securities Exchange Act. In each of these cases, in adopting implementing regulations, the SEC went beyond the requirements of SOX. Under the Securities Exchange Act, the agencies have the ability to revise the reporting regulations as they apply to banking organizations if they find that the implementation of substantially similar regulations with respect to insured banks and savings associations are not necessary or appropriate in the public interest or for the protection of investors.

Section 404 Internal Control Reports

Many community banks are expressing serious concern that the cost of section 404 compliance will significantly outweigh the benefits of the resulting improvements in internal control processes and management's understanding of the effectiveness of these controls. In particular, they do not believe that the effort and expense resulting from additional certifications, documentation and testing requirements are commensurate with the risk from operations.

ACB is concerned that many community banks simply do not have the internal resources to meet the high threshold required by the Public Company Accounting Oversight Board's (PCAOB) attestation standard as it is being implemented by auditors. Banks in this position are facing significant external consulting costs, as well as increases in their auditing fees. Some community banks are reporting audit and attestation fee estimates up to 75 percent higher than what they have paid in the past and some community banks are reporting total fees that equal up to 20 percent of net income. Community banks also are facing a significant increase in legal fees associated with section 404. While we understand that companies will incur the most significant costs during the first year of section 404 compliance, there is strong evidence indicating that compliance costs will remain at a substantial level.

Many small companies already have made the choice to go private, for example, Sturgis Bancorp, Madison Bancshares, Home Financial Bancorp and Fidelity Federal Bancorp. Others are looking for merger partners. To the extent that the goals of SOX are laudable and the statute serves a useful purpose, we believe that the loss of a community bank to a local community is an example of the worst kind of unintended consequence.

The time devoted to section 404 compliance is taking time away from other matters. Executive officers must spend a great deal of time on the minutia required by the auditors at the expense of a focus on daily operations, long-term performance and strategic planning. Internal audit and other departments also are spending significant time with 404, taking away

focus and efforts from other required activities. For example, we have heard reports that, in some instances, community banks have abandoned regular risk audits for this fiscal year to concentrate on 404 compliance. Also, compliance with 404 is adversely affecting the way companies are managed. Some members are indicating that they are being forced to centralize decision-making because the price to be paid for a problem or gap in an area would be too high. Without explicit and reasonable relief from these requirements, many community banks face significant costs and strains on resources that could erode retained earnings and weaken capital adequacy, creating very real safety and soundness issues.

In our recent letter to the SEC on section 404 and our participation in the SEC's public roundtable on April 13, we made the following suggestions for changes to the requirements:

We believe that insured depository institutions should be able to follow the requirements of Part 363 of the FDIC regulations in lieu of compliance with section 404. The PCAOB's requirement for a separate audit of internal controls by the external auditor has created much of the unnecessary burden of the section 404 requirements. Conducting a thorough and detailed review of how management reaches its conclusions about internal controls can be as effective, but considerably more efficient and less burdensome, than the required audit. Requiring an independent audit of internal control over financial reporting is duplicative of work performed by a company's internal audit function and senior management and has resulted in the cost, burden and frustration arising from the PCAOB's Auditing Standard No. 2. Public auditors are interpreting their responsibilities under the standard quite broadly and, in an effort to avoid future liability, are erring on the side of doing too much, rather than not doing enough.

We urged the PCAOB to rethink whether a separate audit of internal controls is really necessary and scale back these standards to a reasonable level of inquiry that allows an auditor to opine on the conclusions reached by management. There are other protections recently put in place that will protect the investing public and that make a more burdensome standard inappropriate. For instance, the chief executive officer and chief financial officer must certify each quarter as to the accuracy of the company's financial statements and their responsibility for establishing and maintaining internal controls. They also must certify that the internal controls have been designed to provide reasonable assurance about the reliability of the financial statements and that they have evaluated the effectiveness of the internal controls. The certifications with regard to the accuracy of the financial statements are made under the threat of criminal liability if the officer knowingly makes a false certification. These new requirements coupled with a thorough review of management's assessment of the internal control environment by the external auditor should provide the protections needed by investors.

If the SEC and the PCAOB do not extend a full exemption to depository institutions, we urge the agencies to consider revising the section 404 approach for them in light of the other significant protections available to investors of a highly regulated depository institution. If the agencies do not believe that this would be warranted for all public depository institutions,

then we urge that a partial exemption from section 404 for the depository institutions exempt from the Part 363 internal control reporting requirements be granted either through a change in the regulations or a change in the law by Congress. The federal banking regulators recognized years ago that internal control reporting and attestation requirements for the smaller community banks would be unduly burdensome, so the requirements were applied only to those institutions with $500 million or more in assets. The agencies felt comfortable with this approach because these smaller institutions are still subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations.

Acceleration of Filing Deadlines

Over the course of the last few years after passage of SOX, the SEC has accelerated the filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and insider beneficial ownership reports under section 16. Unlike larger companies, smaller public community banks do not have employees on staff dedicated to filing these reports so either have to divert attention from other matters to meet stringent deadlines or hire outside help. The two business day deadline for section 16 reports is particularly difficult because these reports are required from principal shareholders, directors and executive officers, and a certain amount of coordination with these parties must be arranged. Also, in light of the significant number of items that now must be reported on Form 8-K, the new four-business day filing requirement takes its toll on staff. Smaller companies do not have the staff resources to handle the increasing amount of information that has to be filed. Also, shorter deadlines only encourage those investors who already have a short-term outlook on investments when it seems prudent to encourage longer-term investment objectives.

We suggest that the deadlines for insured depository institutions be changed to 10 calendar days for filing current reports on Form 8-K and section 16 beneficial ownership reports.

When the SEC accelerated the deadlines for periodic reports, it provided an exemption from the new deadlines for smaller companies. However, larger companies are also now experiencing problems with the deadlines in light of the substantial work that must be done to comply with SOX section 404. Therefore, the SEC and the agencies should consider freezing the current deadlines that are now in place rather than phasing in the final step in the acceleration schedule that would require annual reports be filed within 60 days and interim reports be filed within 35 days.

Annual Independent Audits and Reporting Requirements (Part 363)

In 1991, the exemption from the external independent audit and internal control requirements in Part 363 for depository institutions with less than $500 million in assets was adequate. With the increasing consolidation of the banking industry, coupled with the application by external auditors of the public company auditing standard to FDICIA banks, this exemption threshold needs to be increased to reduce burden on the smaller institutions. We have heard

that many privately held and mutual community banks with assets between $500 million and $1 billion are experiencing substantial audit fee increases coupled with serious strains on internal resources in complying with the FDICIA requirements. We believe an increase in the threshold to $1 billion in assets will provide much needed relief for these institutions.

Transactions with Affiliates

The Federal Reserve Board issued Regulation W at the end of 2002 to implement sections 23A and 23B of the Federal Reserve Act. ACB has the following suggestions for reducing the burden of this regulation.

All state bank subsidiaries should be exempt from the requirements and restrictions of Regulation W, other than those subsidiaries that engage in activities specifically mentioned in section 121(d) of the Gramm-Leach-Bliley Act (i.e., subsidiaries engaging as principal in activities that would only be permissible for a national bank to conduct through a financial subsidiary). Also, Regulation W should exempt any subsidiary relationship that would not have been subject to sections 23A and 23B prior to the date that Regulation W was issued. These exemptions were supported by an FDIC proposed rulemaking in 2004. The activities of these subsidiaries, while not authorized for national banks to perform directly, have been conducted safely and prudently for some time. The activities are authorized by state law and must comply with the requirements of the Federal Deposit Insurance Act, the FDIC's regulations, and prudential conditions in any approval order. Nothing in the history of these subsidiaries' operations suggests safety and soundness concerns that would warrant wholesale application of Regulation W.

If this exemption is deemed to be too broad, then we request an exemption to be extended at least for those state bank subsidiaries that engage only in agency activities. Agency activities typically do not require the same level of capital investment as other subsidiaries and generally do not pose significant risks to their parent depository institutions. The regulatory burden associated with applying Regulation W to these types of subsidiaries is not justified by any incremental supervisory benefits that might result.

The definition of "general purpose credit card" set forth in section 223.16(c)(4) is unduly restrictive in limiting the percentage of transactions involving the purchase of goods and services from an affiliate to 25 percent. So long as a majority of these transactions is between bank customers and nonaffiliated parties, this exemption should be available.

Frequency of Safety and Soundness Examinations

Safety and soundness exams are conducted on an annual basis, except that smaller depository institutions that meet certain requirements are examined on an 18-month cycle. One of those requirements is that the institution have assets of $250 million or less. ACB believes that this threshold should be increased to at least $500 million. Institutions that cross over the $250 threshold experience significantly increased burden from more intense examinations

conducted more frequently. These institutions still are quite small and they have limited staff resources to devote to the examination process. We believe a higher threshold would be appropriate in light of the protection afforded by the other requirements of the less frequent exam cycle: the institution must be well capitalized and well managed, have one of the two highest ratings from its previous examination, and not be subject to any formal enforcement proceeding or order. Furthermore, the regulators have the authority to conduct more frequent examinations, as they may deem necessary.

Financial Management Policies

Section 563.170(d) of the rules and regulations of the OTS requires a savings association to have a resolution passed by its board of directors and a certified copy sent to the Regional Director before transferring records, or the maintenance of records, from or between the home office or any branch or service office. ACB recommends that this requirement be deleted or that only an after-the-fact written notice of a transfer to the Regional Director be required if records are transferred from a home office to a branch or service office, or from a branch or service office to the home office or another branch or service office. As long as maintenance and possession of the records are kept under the control of the savings association and not sent to a third party, an after-the-fact letter should be sufficient.

Section 563.170(e) requires that a savings association provide at least 90 days notice prior to maintaining any of its records by means of data processing services. This notice requirement should be deleted or reduced to 30 days.

Rules on the Issuance and Sale of Institution Securities

The requirement in section 563.5 that savings association certificates must include a statement about the lack of FDIC insurance should be moved to a place where it is adjacent to relevant material and can be more easily found. For example, the requirement would be more appropriate in section 552.6-3, which discusses the certificates for savings association shares generally.

Securities Offerings.

The notice requirements in sections 563g.4(c) and 563g.12 should be deleted as it should not be necessary to report the results of an offering 30 days after the first sale, every six months during the offering, and then again 30 days after the last sale.

Recordkeeping and Confirmation of Securities Transactions Effected by Banks

The FDIC, OCC and the Federal Reserve should conform their rules to those of the OTS and permit quarterly statements, rather than monthly statements, be sent for transactions in cash management sweep accounts. This will reduce the burden for national and state-chartered banks without adversely affecting bank customers. Most investment companies provide statements on a quarterly basis and customers are comfortable with this level of frequency.

Appraisal Standards for Federally Related Transactions

Each of the agencies requires that appraisals on residential real estate be conducted by state certified or state licensed appraisers for federally related transactions in excess of $250,000. We urge each of the agencies to amend its regulations to reflect the home price appreciation and inflation that has occurred in the years since the adoption of the final appraisal regulations in 1992. We suggest amending the regulation to aligning the threshold with the current conforming loan limits for Fannie Mae and Freddie Mac. As the conforming loan limit increases (or decreases), the threshold would increase (or decrease). When the final regulation was adopted the conforming loan limit was $202,300. Today it is $359,650, but the exemption threshold has remained unchanged.

This disparity puts federally regulated institutions at a disadvantage to their non-regulated competitors. It also disregards the innovations in automated loan underwriting and automated valuation models that are in such wide usage today. These innovations in underwriting and valuing property help lenders compete for business by providing simplified property evaluations, reducing borrowers' costs, and accelerating the loan approval process. For example, a typical automated valuation report obtained via the Internet costs about $30 and is very reliable, while it costs approximately $300 to hire a state certified appraiser.

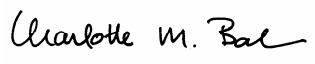
Conclusion

We live in a world where criminals seek to abuse our financial system and terrorists plot to change our way of life. We understand that anti-money laundering laws and regulations are necessary, but believe that the implementation of anti-money laundering requirements can be improved. Bottomline, the intentions behind these rules may be grounded in doing good yet their implementation is causing very real and measurable harm. Legitimate customers are being denied service and banks are being forced to adhere to an unattainable standard of perfect compliance. Without real regulatory relief our country will lose more community banks that opt out of burden.

ACB strongly urges the federal banking agencies to use this stage of the EGRPRA project to look at BSA oversight anew. We specifically request the agencies to articulate clear policy and ensure that the regional offices carry out that policy consistently. We again express our appreciation for the newly released MSB guidance and urge the agencies to work with FinCEN to produce further guidance on suspicious activity reporting and OFAC compliance.

We also urge the agencies to review the requirements of SOX as they are imposed on insured depository institutions. We stand ready to work with the agencies as this regulatory relief project progresses. We appreciate the opportunity to provide comments on all of these important matters. Please do not hesitate to contact the undersigned at (202) 857 3121 or cbahin@acbankers.org if you have questions about any of the issues addressed in this letter.

Sincerely,



Charlotte M. Bahin
Senior Vice President, Regulatory Affairs

December 23, 2004

William J. Fox
Director
Financial Crimes Enforcement Network
2070 Chain Bridge Road, Suite 200
Vienna, VA 22182

Re: SAR Resource Guide and Regulatory Issues

Dear Director Fox:

America's Community Bankers (ACB)[12] has been pleased to work with the Financial Crimes Enforcement Network (FinCEN) to provide feedback regarding various Bank Secrecy Act (BSA) related issues, including the development of new regulations to implement the USA Patriot Act. We wish to continue that relationship by making additional suggestions for improving BSA compliance, particularly in the area of suspicious activity reporting.

ACB requests FinCEN, as administrator of the BSA, to provide an updated, centralized resource guide regarding suspicious activity reporting that 1) helps institutions understand what kinds of transactions and occurrences are suspicious and reportable and 2) addresses other SAR related issues and frequently asked questions (FAQ's). We believe that such centralized guidance would be a helpful resource to community bankers and may be one way to help reduce the problem of defensive SAR filing.

Suspicious activity reporting has taken on new significance in our post-September 11th world, and FinCEN and the federal banking regulators expect institutions of all sizes and geographic locations to institute policies and procedures to detect possible illegal activity. In this era of increased regulatory scrutiny, community banks deserve more guidance and information. Otherwise, the anti-money laundering demands imposed on them are very unfair.

Accordingly, we request FinCEN to compile a comprehensive guide to SAR reporting that includes:

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[12] America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

1. A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity triggers a SAR filing?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question is also important in helping to separate those occurrences that should not be reported to FinCEN. We also encourage FinCEN to include examples or case studies where SARs are or are not warranted.

2. FAQ's and key points made by previous SAR Activity Reviews. We appreciate the efforts of FinCEN to compile the semi-annual SAR Activity Review. This publication has been helpful in communicating SAR tips, trends, and issues, and we strongly urge FinCEN to continue to publish this document. However, we believe that it would be helpful to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:

    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. We understand that the federal banking agencies are working to finalize interagency BSA examination procedures. We believe that the exam procedures will help clarify the regulators' BSA expectations, but we are skeptical that the procedures will provide a comprehensive suspicious activity reporting guide for community bankers. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (Dec 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

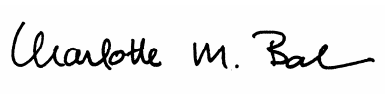
The uncertainty surrounding whether to file a SAR is compounded by the fact that many bankers have heard FinCEN's plea not to file defensive SARs. Simply requesting institutions not to file defensive SARs will not eliminate this problem. FinCEN must help institutions understand how to separate the wheat from the chaff and must work to ensure that the banking regulators do not create a culture that motivates institutions to file unnecessarily. ACB members are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

One community banker recently told of an instance where he was unsure whether certain activity should be deemed suspicious. He called FinCEN's regulatory helpline only to be told that FinCEN does not comment on whether a particular activity triggers a SAR reporting obligation. While FinCEN obviously cannot comment without knowing all of the facts and circumstances surrounding a particular case, this instance is illustrative of the dilemma faced by many community bankers who are unsure whether to file a SAR.

ACB urges FinCEN to give serious consideration to our request for the development of an updated, centralized, comprehensive guide to suspicious activity reporting. Such a resource would be helpful to community banks, and ultimately law enforcement, as we pursue our common goal of preventing terrorism and other crimes. We also trust that FinCEN will work with the federal banking agencies to help eliminate the contradictory messages that are being sent about suspicious activity reporting.

ACB looks forward to working with FinCEN on this and other issues pertaining to BSA compliance. Please contact the undersigned at 202-857-3121 or Krista Shonk at 202-857-3187 should you have any questions. Thank you for your consideration.

Sincerely,



Charlotte M. Bahin
Senior Vice President
Regulatory Affairs

Appendix B

to

America's Community Bankers'

Testimony

on

Financial Services Regulatory Relief: Private Sector Perspectives

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

of the

United States House of Representatives

on

May 19, 2005

May 6, 2005

Ms. Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Attention: Docket No. OP-1220

Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington D.C. 20219

Attention: Docket No. 05-01

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington D.C. 20552

Attention: No. 2005-02

Re: Request for Burden Reduction Recommendations; Money Laundering, Safety and Soundness, and Securities Rules; Economic Growth and Regulatory Paperwork Reduction Act of 1996 Review
70 FR 5571 (February 3, 2005)

Dear Sir or Madam:

America's Community Bankers (ACB)[1] is pleased to comment on the federal banking agencies' (the agencies)[2] review of regulatory burden imposed on insured depository institutions.[3] Required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),[4] the agencies are reviewing and identifying outdated, unnecessary, and unduly burdensome regulatory requirements. This comment letter responds to the request for comments regarding money laundering, safety and soundness, and securities rules.

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[1] America's Community Bankers is the national trade association partner for community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

[2] Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve Board (the "Board"), Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

[3] 70 Fed. Reg. 5571 (February 3, 2005).

[4] Pub. L. 104-208, Sept. 30, 1996.

ACB Position

ACB strongly supports the agencies in their ongoing efforts to reduce the regulatory burden on insured depository institutions. Generally, the statutes enacted and the required implementing regulations serve a very useful purpose by themselves, but when layered upon the existing requirements, community banks frequently must comply with overlapping and voluminous regulations. Several of the regulations that are the subject of this request for comment are among those that community bankers raise as the being the most burdensome. We welcome the scrutiny of the agencies on these regulations and we hope that this review results in changes that relieve some of the regulatory burden while preserving the benefits of the requirements.

Anti-money laundering regulations

The anti-money laundering statutes and the implementing regulations were adopted with the best of intentions. The Bank Secrecy Act (BSA) was enacted in 1970 and one of the primary goals was to eliminate or mitigate the laundering of the profits of drug trafficking and other illicit businesses. The USA Patriot Act was enacted to root out terrorists, ensure the safety of the American people, and protect the integrity of the U.S. financial system. ACB supports the goals of these laws, however, inconsistent interpretation of the implementing regulations by examiners and a lack of regulatory guidance have made it increasingly difficult for community banks to comply with anti-money laundering demands and have produced a plethora of unintended consequences.

ACB offers the following suggestions to improve BSA oversight.

Consistent Implementation

Community banks are frustrated by the conflicting messages conveyed by banking regulators. Washington officials repeatedly assure the industry that the banking agencies do not have "zero tolerance" for anti-money laundering deficiencies. Nevertheless, regional offices and individual examiners continue to use this language when conducting BSA examinations and when making presentations during industry conferences. ACB is very pleased that Washington acknowledges that perfect compliance is impossible. We urge the agencies to ensure that all regional offices and examiners understand and adhere to this fundamental principle of regulatory policy.

ACB hopes that the anticipated interagency examination procedures will clarify the regulators' compliance expectations and will provide consistency across and within the agencies. It is important that institutions understand what is expected of them, yet many community banks believe that there are no pre-established standards against which their compliance efforts will be evaluated. Accordingly, we urge the agencies to make every effort to ensure that the examination procedures are made available by June 30, 2005, as promised.

Suspicious Activity Reporting

Examination for compliance with suspicious activity reporting requirements is one specific area where we ask the regulators to be more consistent and provide additional guidance.

Defensive SARs. The federal banking agencies are scrutinizing suspicious activity reporting more closely than ever and anxiety over whether an institution should file a SAR is at an all-time high. As a result, many depository institutions believe that filing more SARs is the key to avoiding regulatory criticism. Many institutions file SARs as a defensive tactic to stave off "second guessing" of an institution's suspicious activity determinations. This mindset is fueled by examiners who criticize institutions for not filing enough SARs based on their asset size. Furthermore, regulators have admitted in public fora that the agencies do not discourage the "when in doubt, fill it out" strategy.[5] Finally, enforcement actions in the past year appear to confirm the idea that it is better to have filed a SAR when it is not necessary than to have not filed one.

It is more time consuming and paperwork intensive for an institution to document why it elected not to file a SAR than to simply file the report. Institutions believe that the risk of regulatory criticism is higher for not filing and that examiners will disapprove of the bank's documentation or its decision not to file.

While institutions feel pressure to file more SARs by their primary regulator, FinCEN director William Fox has warned that the value of SAR data will be less valuable and that the integrity and usefulness of the SAR system will be compromised by the onslaught of "defensive" SARs. In March 2005, financial institutions submitted nearly 43,500 SARs, up 40 percent from March 2004. Director Fox recently wrote in the April 2005 *SAR Activity Review*, "these 'defensive filings' populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns."

The problem of defensive SAR filing is further exacerbated by recent deferred prosecution agreements between the Department of Justice and financial institutions whose SAR reporting programs have been deemed deficient.

In this era of increased regulatory scrutiny, community banks deserve more guidance and information. ACB strongly urges the regulators to work with FinCEN and the Department of Justice to articulate a single, clear policy on suspicious activity reporting that is applied consistently. It is critical that this policy be made clear to the regional offices, bank examiners and officials of the Department of Justice across the country.

Further, we do not believe that insured institutions should be placed in the middle of a harsher enforcement regime when the federal agencies attempt to satisfy their Inspectors General. Rather, the banking regulators, FinCEN, and the Department of Justice should work to help institutions identify activities that are genuinely suspicious and should be reported. We are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

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[5] While most industry feedback indicates that community banks feel pressured to file larger quantities of SARs, some institutions have been cautioned by their regulators against such liberal filing. This approach, too is frustrating.

The current state of affairs is not the best use of the time and resources of all parties involved and is not helping to enhance the security of our country.

SAR Guidance. On December 23, 2004, ACB requested that FinCEN provide updated, centralized SAR reporting guidance (See Attachment A). In a response from FinCEN dated April 22, 2005, we have been assured that many of the points raised are being addressed. We welcome the changes and urge the agencies to work with FinCEN to ensure rapid dissemination of any changes and guidance. ACB continues to believe that not understanding what constitutes suspicious behavior continues to be one of the most burdensome aspects of BSA compliance. Accordingly, we urge the agencies to work with FinCEN to compile a comprehensive guide to SAR filing that includes:

- A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity is indicative of terrorist finance?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question also is important in helping to separate those occurrences that should not be reported. We also encourage the agencies and FinCEN to include examples or case studies where SARs are or are not warranted.
- Centralized Guidance. Over the years, FinCEN and the federal banking agencies have produced helpful guidance, interpretations, and answers to frequently asked questions. While this information is useful, it has not been compiled in a centralized location. Accordingly, we ask the agencies to work with FinCEN to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:
    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (December 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

Account Monitoring Software. Increasing numbers of community banks have been instructed by their examiners to purchase account monitoring software to help identify suspicious activity. However, it is unclear at what point the regulators will expect institutions to install such software. Some institutions have been told that in certain geographic locations, institutions with more than $250 million in assets are "strongly encouraged" to implement an account/customer

monitoring software system. Representatives from the federal banking agencies have told ACB that they do not intend to identify the circumstances under which institutions will be expected to install such monitoring software.

We thoroughly agree that a one-size fits all approach is not appropriate. However, it would be very helpful for the agencies to elaborate on the circumstances under which such account monitoring systems should be considered. The cost of purchasing these systems is significant, and helping community banks to better understand when such systems will be required will enable institutions to better budget and plan for this large expense. Account monitoring software packages used by community banks often cost between $30,000 and $50,000 (and sometimes much more), plus a $5,000 per month service charge or maintenance fee. In many cases, institutions must hire additional personnel or take existing staff away from other bank responsibilities to run the software, review flagged accounts, and file SARs when necessary.

Some community banks have been instructed to use their account monitoring software to drill down to the fourth level of an account relationship (i.e. the fourth person listed on a signature card) to study tax identification numbers, names, and addresses for suspicious information. Many institutions report that they have difficulty making those correlations on the second level, let alone the fourth. We believe that the agencies are working with law enforcement to determine how money launderers adjust their techniques and are asking the industry to adjust its account monitoring processes accordingly.

Characterization of BSA Violations

ACB believes that BSA enforcement should be consistent, particularly with regard to whether BSA violations are characterized as "program violations" or "FinCEN violations." The federal banking agencies have indicated that compliance problems identified as "program violations" will result in an automatic written supervisory agreement with the institution, while problems classified as "FinCEN violations" will be addressed more informally.

The characterization of an institution's BSA violations has strong repercussions beyond the formality with which problems will be addressed. The characterization of compliance problems as "program violations" may affect the institution's CAMELS rating, its ability to merge with or purchase other institutions, build or acquire new branches or expand into new product lines. For publicly traded banks, a written, formal agreement may also warrant disclosure in filings with the Securities and Exchange Commission. Because the characterization of BSA violations has such a significant impact on the institution, ACB urges the banking agencies to emphasize the importance of this matter when training and updating their examiners.

We have heard a number of examination experiences that provide useful examples. One community bank that recently underwent a BSA compliance exam was cited by its examiners for failure to identify a local business as an money service business (MSB) and failure to file a suspicious activity report on that same business. The institution is well-capitalized and well managed and filed approximately 4,500 SARs last year. The report of examination devoted one paragraph to BSA issues and the institution took the required corrective actions, believing the matter to be closed. Over six months later, the institution's regional regulator re-characterized the violations as "program violations" and presented the bank with a written supervisory

agreement. The bank ultimately persuaded the regional office to address the matter less formally, but the process remains unclear and too subjective.

It is imperative that examiners and regional offices understand how classifying violations as one form or another affects an institution. We urge the regulators to work to ensure that such characterizations are applied correctly, consistently, and in a timely manner.

Money Services Businesses

The provision of banking services to MSBs and an institution's corresponding regulatory requirements have been widely discussed within the banking industry in recent months. ACB believes that the issues underlying the supervision of depository institutions that provide banking services to MSB's are an extension of larger problems that permeate the entire BSA oversight mechanism.

MSB's play an important role in providing financial products and services to persons that do not have a traditional banking relationship with a depository institution. Many small businesses that are now dubbed MSBs have been good customers for community banks. Grocery stores, truck stops, and even feedstores are examples of the types of businesses that now fall within the category of MSBs because they cash checks in excess of $1,000 per person per day.

For example, depository institutions have been pressured by examiners to close accounts of long-time customers that may be considered to be a "money service business." Other institutions believe that the due diligence requirements for these accounts outweigh the benefit of having MSBs as customers. Many institutions are unwilling to take on the compliance risk now associated with MSB accounts. Others do not believe that they have an adequate understanding of what constitutes unusual activity for MSBs in general and have indicated that they will not bank MSB customers until they have more direction from FinCEN and the banking regulators.

On March 8, 2005, ACB was pleased to participate in the joint meeting of the Non-bank Financial Institutions and Examinations Subcommittee of the Bank Secrecy Act Advisory Group to discuss the provision of banking services to MSBs. This meeting explored why financial institutions large and small closed the accounts of their MSB customers. We believe that the meeting helped underscore the need for regulatory guidance and consistent interpretation of enhanced due diligence requirements for depository institutions that have MSB customers.

ACB also is very appreciative of the March 30, 2005 joint statement issued by the federal banking agencies and FinCEN clarifying that depository institutions are not expected to serve as a *de facto* regulator of the money services business industry. Notwithstanding the important policy positions articulated in the joint release, community banks are not re-opening accounts for MSBs in wide numbers. Furthermore, institutions continue to have varying interpretations of the regulatory requirements associated with banking MSBs.

We believe that this problem will be remedied by the joint guidance issued by FinCEN and the banking agencies on April 26, 2005. ACB is very encouraged that the agencies and FinCEN acted on requests for guidance and explained the different kinds of risks and appropriate due

diligence required for MSB accounts. We also appreciate the examples of suspicious activity that the guidance provides. We hope that the guidance will help examiners evaluate the banking industry's monitoring of MSB accounts more consistently.

While the guidance on appropriate monitoring of MSB accounts is welcome, we believe that additional compliance questions should be addressed. Namely, how financial institutions should treat those businesses that engage in "MSB activity" in rare circumstances.

For example, a community bank reported that local farmers sometimes take on odd jobs to earn extra money. On occasion, a farmer will endorse his paycheck over to the local feedstore in exchange for goods. An examiner that interpreted the MSB requirements narrowly believed that the feedstore should be treated as an MSB. However, we do not believe that it is reasonable to require the feedstore to register as an MSB, nor is it appropriate to require a financial institution to monitor the account as such. Accordingly, we request the banking agencies to work with FinCEN to identify situations that are exempt or should be exempt from the MSB requirements.

We also encourage the regulators to help institutions recognize unidentified MSBs. Community banks are very concerned that they are unknowingly providing banking services to customers that are operating as MSBs and worry that they will face regulatory criticism for failing to identify these accounts. ACB requests the federal banking agencies to provide guidance on transaction patterns and other indicia of common MSB account activity. This information would help community banks identify business customers that qualify as MSBs and inform them of the associated registration and compliance requirements. In many cases, businesses do not know what an MSB is, much less that there are regulatory requirements for engaging in this activity. Finally, community banks are concerned about allegations of discrimination in connection with MSB accounts. Institutions have deemed some MSBs to pose a higher risk of money laundering than others. In many cases, banks are not equipped to monitor high-risk MSB accounts properly and have terminated these account relationships. Institutions worry that they will be accused of discriminatory practices for maintaining some MSB accounts but not others. Reputation risk in the community is a very real concern to community banks.

OFAC

The prohibition against processing transactions for persons and entities designated by the Office of Foreign Assets Control (OFAC) is not new. However, renewed focus on anti-money laundering efforts has raised many questions regarding an institution's obligations in this area.

OFAC simply prohibits financial institutions from processing a transaction for persons and entities on the OFAC list and institutes a strict liability standard for non-compliance that will result in monetary penalties. This broad standard does not address many practical questions that community banks have about OFAC compliance. For example, what is an institution's obligation regarding checking automated clearing house transactions? Are obligations different for originating or receiving institutions? ACB has heard that the Federal Reserve Board is considering implementing a program that may screen all ACH items and wire transfers against the OFAC list. While there would be many unanswered questions regarding how any "hits" would be addressed and who would have the obligation to freeze a transaction, we believe that

Federal Reserve screening of ACH payments would provide valuable regulatory relief to community banks. ACB urges the Federal Reserve to seriously consider this option.

Community banks also ask how frequently they should check their customer base against the OFAC list or how soon they should check the OFAC list when presented with certain transactions. We understand that the agencies view these decisions as being "risk-based," but community banks need help understanding what the risk factors are. In addition, it would be instructive for the agencies to articulate their approach in the event an institution processes a transaction involving a person or entity on the OFAC list. U.S. banks process millions of financial transactions each day, and it is impossible to screen all interested parties against the OFAC list. Inevitably, some prohibited transactions will be processed. ACB requests the agencies to specify that they will not take regulatory action independent of OFAC sanctions.

ACB is pleased that the banking agencies and FinCEN have been able to work with OFAC to determine that, as a general matter, SAR requirements will be satisfied if an institution files a blocking report with OFAC in accordance with OFAC's Reporting, Penalties, and Procedures Regulations. OFAC will then provide the information to FinCEN for inclusion in the SAR reporting database, where it will be made available to law enforcement. The filing of a blocking report with OFAC, however, will not satisfy an institution's obligation to identify and report suspicious activity beyond the fact of an OFAC match. ACB believes that this clarification provides meaningful regulatory relief for community banks by eliminating what is essentially a duplicative reporting requirement to the U.S. Department of the Treasury.

Currency Transaction Reports

FinCEN regulations require financial institutions to file currency transaction reports for all cash transactions over $10,000.[6] FinCEN's regulations establish an exemption system that relieves financial institutions from filing CTRs on the cash transactions of certain entities, provided certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance. The exemption process was well intentioned, but community banks have been reluctant to use the exemption system because:

- It is not cost effective for small institutions that do not file many CTRs.
- They fear regulatory action in the event that an exemption is used incorrectly.
- They lack the time to conduct the research necessary to determine whether a customer is eligible for an exemption.
- It is easier to automate the process and file a CTR on every transaction that triggers a reporting requirement.
- The regulations and the exemption procedures and requirements are overly complex.

As a result, financial institutions have filed over 12 million CTRs each year since 1995.[7] FinCEN and law enforcement report that the CTR database is littered with unhelpful CTRs because financial institutions do not use the exemption procedures that are designed to eliminate

[6] 31 CFR 103.22(b)(1).
[7] FinCEN Report to Congress, *Use of Currency Transaction Reports* (October 2002).

CTRs that are of no interest to law enforcement. As a result, it is more difficult to use the database to investigate possible cases of money laundering or terrorist finance.

ACB believes that currency transaction reporting requirements are ripe for review. We suggest the following reforms to ease regulatory burden on financial institutions and improve the utility of the CTR database for law enforcement.

CTR Reporting Threshold. ACB strongly supports raising the dollar value that triggers CTR filing. Increasing the reporting requirement would dramatically decrease the number of CTRs that are filed each year and would provide much needed relief from BSA regulatory burden.

An update of the CTR regulations is long overdue because the current rules have not kept pace with the economy. Since 1970, institutions have been required to file CTRs on cash transactions over $10,000. When adjusted for inflation, $10,000 in 1970 is equivalent to $50,335 today. [8] We have heard that when the regulations were first implemented, there was very little activity over the $10,000 threshold. Today, however, such transactions are routine, particularly for cash intensive businesses.

Based upon data that FinCEN provided to the Bank Secrecy Act Advisory Group's ("BSAAG") CTR Subcommittee, increasing the reporting threshold to $20,000 would decrease CTR filings by 57 percent and increasing the threshold to $30,000 would decrease filings by 74 percent.[9] The impact of raising the dollar value is even more astonishing for community banks. An informal survey of ACB members conducted in June 2004 indicates that increasing the dollar amount to $20,000 would reduce community bank CTR filings by approximately 80 percent. Even with the dramatic change in the value of $10,000 over the past thirty years, ACB acknowledges that a $10,000 cash transaction is still a substantial amount of cash for an individual customer to deposit or withdraw from an institution. However, businesses of all sizes routinely conduct transactions over $10,000.

Some law enforcement officials strongly oppose adjusting the dollar value that triggers CTR reporting out of a concern that doing so would decrease the amount of data that could potentially assist in a future criminal investigation. As a practical matter, the 30-year old CTR filing requirements need to be updated to reflect today's economic reality. We believe that updating the regulations would help, not hinder the investigatory process. The reduction in the number of CTR filings would meet the Congressional mandate to reduce CTR filings by 30 percent, as required by the Money Laundering Suppression Act of 1994. More importantly, users of CTR data would benefit from a cleaner, more efficient CTR database. Raising the threshold does not mean that institutions will be relieved from monitoring account activity for suspicious transactions below the CTR reporting requirement. Increasing the threshold would enable financial institutions to alert law enforcement about activity that is truly suspicious or indicative of money laundering, as opposed to bogging down the data mining process by filing reports on routine business transactions.

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[8] Federal Reserve Bank of Minneapolis inflation calculator. http://woodrow.mpls.frb.fed.us/research/data/us/calc/
[9] FinCEN. *CTRs Posted By Amount Range*, (2004).

Exemption System. A discussion of solutions to reduce the number of CTR filings would not be complete without addressing the exemption system that relieves financial institutions from filing CTRs on certain entities.[10] While the exemption scheme was designed to minimize the number of CTRs that institutions file, community banks have reported that the cost of using the exemptions outweighs any associated benefits.

The exemption requirements are particularly challenging for community bankers that perform multiple functions within an institution and simply do not have the time to study the requirements and apply them to specific customers. In addition, institutions are reluctant to use the exemptions for fear of applying the rules incorrectly. As a result, many community banks have elected to automate the CTR reporting process and file on every transaction over $10,000.

There has been discussion in the financial community about providing interpretive guidance that provides examples and explains how to apply the rules. While guidance would be helpful, we do not believe that it would lead to a significant reduction in CTR filings. Even if guidance is issued, most community banks that have elected not to use the exemption process will continue to file on all cash transactions over $10,000. This compliance method is cost effective and exposes institutions to minimal compliance risk.

While many community banks do not use the exemption process, those that do would like to exempt customers more quickly than currently permitted by regulation. Before an institution can exempt a customer as a non-listed business or payroll customer, the customer must have maintained a transaction account with the bank for at least twelve months.[11] The 12-month rule was adopted to ensure that an institution is familiar with a customer's currency transactions.

ACB encourages the agencies to work with FinCEN to allow institutions to more quickly exempt business customers. Recent regulations implementing the Patriot Act allow institutions to make risk-based decisions about their anti-money laundering efforts. Likewise, FinCEN should give institutions greater discretion in determining when to exempt a business customer from CTR reporting. A community bank, not a regulatory agency, is in the best position to determine whether it is sufficiently familiar with a customer's account activity.

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[10] Pursuant to the Money Laundering Suppression Act, FinCEN established two categories of transactions that are exempt from CTR reporting. Phase I exemptions (31 CFR 103.22 (d)(2)(i)-(v)) apply to banks, government agencies, government instrumentalities, publicly traded businesses (referred to in the regulations as a "listed business") and certain subsidiaries of publicly traded businesses. A business that does not fall into any of the above categories may still be exempted under the Phase II exemptions (31 CFR 103.22 (d) (2) (vi)-(vii)) if it qualifies as either a "non-listed business" or as a "payroll customer." The new rules also established specific procedures for exempting eligible customers. In determining whether to exempt a customer, a depository institution must document such steps a reasonable and prudent institution would take to protect itself from loan or other fraud or loss based on misidentification of a person's status. The institution must document the basis for its decision to exempt a customer from currency transaction reporting and maintain such documents for five years. After an institution has decided to exempt a customer, the bank must file a Designation of Exempt Person form within 30 days after the first customer transaction the institution wishes to exempt. For Phase I customers, the form has to be filed only once (though the institution must annually review the customer's status). For Phase II customers, the form must be refiled every two years as part of the biennial renewal process. As with Phase I customers, the bank must also annually review the status of Phase II customers.

[11] 31 C.F.R. 103.22(d)(2)(vi)(A), (d)(2)(vii)(A).

While allowing institutions to take a risk-based approach would not significantly reduce CTR filings, it would provide regulatory relief to those institutions that elect to use the exemption process.

Compliance Costs

Depository institutions are pillars of their communities and are an important part of the larger U.S. economy. As such, community banks are committed to ensuring our nation's physical security and the integrity of our financial system. BSA compliance costs have skyrocketed since the Patriot Act was signed into law. Increasingly, financial institutions believe that the federal government has little regard for the amount of time, personnel, and monetary resources that BSA compliance drains from a institution's ability to serve its community.

As mentioned earlier, institutions that purchase account monitoring software to flag suspicious transactions or other unusual circumstances easily costs $30,000 (and sometimes hundreds of thousands of dollars) upfront and $5,000 each month thereafter. Sometimes, institutions hire new personnel just to study the "red flags" identified by the software to determine if the flagged activity warrants a SAR filing. Furthermore, community banks commonly spend an initial $5,000 plus transaction fees to access identity "verification" databases to help satisfy the Patriot Act's customer identification requirements.

To put these figures into context, the monthly fee for suspicious activity monitoring software is money that an institution could have spent to hire multiple tellers, hire a new loan officer to reach out to the community's small businesses, or develop and market a new product. What may seem like insignificant costs to lawmakers in Washington have very real business implications for community banks and their communities.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers. In recent months, waves of depository institutions severed ties with MSB customers due to pressure from examiners, regulatory uncertainty, or simply being overwhelmed by regulatory requirements associated with these accounts. Community banks have also opted not to open accounts for non-resident aliens and other persons out of fear that the institution will not be able to meet the "reasonable belief" standard established in the customer identification requirements. While many institutions accept the matricula consular as a form of identification, others have taken a cautious approach to compliance and have elected not to accept the card. As a result, come community banks forego opportunities to establish banking relationships with the unbanked and promote financial literacy among this segment of the population – all because of concerns that the bank will not be able to satisfy regulatory requirements.

Reporting Requirements Under the Securities Exchange Act of 1934

The Sarbanes-Oxley Act of 2002 (SOX) significantly increased the burden of reporting under the Securities Exchange Act of 1934 for all public companies, but particularly for community banks.

Much of that burden was imposed by the Securities and Exchange Commission (SEC) in implementing regulations. We believe that the SEC has issued final rules that include expanded the reporting requirements that go beyond what was required by SOX. ACB understands that many of the regulations addressed in this section of the letter have been promulgated by the SEC and that the agencies incorporate these regulations by reference into their regulations. We strongly urge the agencies to work with the SEC to minimize the reporting burden for community banks.

Two areas of great concern are internal control requirements under section 404 of SOX and the acceleration of filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and beneficial ownership reports under Section 16 of the Securities Exchange Act. In each of these cases, in adopting implementing regulations, the SEC went beyond the requirements of SOX. Under the Securities Exchange Act, the agencies have the ability to revise the reporting regulations as they apply to banking organizations if they find that the implementation of substantially similar regulations with respect to insured banks and savings associations are not necessary or appropriate in the public interest or for the protection of investors.

Section 404 Internal Control Reports

Many community banks are expressing serious concern that the cost of section 404 compliance will significantly outweigh the benefits of the resulting improvements in internal control processes and management's understanding of the effectiveness of these controls. In particular, they do not believe that the effort and expense resulting from additional certifications, documentation and testing requirements are commensurate with the risk from operations.

ACB is concerned that many community banks simply do not have the internal resources to meet the high threshold required by the Public Company Accounting Oversight Board's (PCAOB) attestation standard as it is being implemented by auditors. Banks in this position are facing significant external consulting costs, as well as increases in their auditing fees. Some community banks are reporting audit and attestation fee estimates up to 75 percent higher than what they have paid in the past and some community banks are reporting total fees that equal up to 20 percent of net income. Community banks also are facing a significant increase in legal fees associated with section 404. While we understand that companies will incur the most significant costs during the first year of section 404 compliance, there is strong evidence indicating that compliance costs will remain at a substantial level.

Many small companies already have made the choice to go private, for example, Sturgis Bancorp, Madison Bancshares, Home Financial Bancorp and Fidelity Federal Bancorp. Others are looking for merger partners. To the extent that the goals of SOX are laudable and the statute serves a useful purpose, we believe that the loss of a community bank to a local community is an example of the worst kind of unintended consequence.

The time devoted to section 404 compliance is taking time away from other matters. Executive officers must spend a great deal of time on the minutia required by the auditors at the expense of a focus on daily operations, long-term performance and strategic planning. Internal audit and

other departments also are spending significant time with 404, taking away focus and efforts from other required activities. For example, we have heard reports that, in some instances, community banks have abandoned regular risk audits for this fiscal year to concentrate on 404 compliance. Also, compliance with 404 is adversely affecting the way companies are managed. Some members are indicating that they are being forced to centralize decision-making because the price to be paid for a problem or gap in an area would be too high. Without explicit and reasonable relief from these requirements, many community banks face significant costs and strains on resources that could erode retained earnings and weaken capital adequacy, creating very real safety and soundness issues.

In our recent letter to the SEC on section 404 and our participation in the SEC's public roundtable on April 13, we made the following suggestions for changes to the requirements:

We believe that insured depository institutions should be able to follow the requirements of Part 363 of the FDIC regulations in lieu of compliance with section 404. The PCAOB's requirement for a separate audit of internal controls by the external auditor has created much of the unnecessary burden of the section 404 requirements. Conducting a thorough and detailed review of how management reaches its conclusions about internal controls can be as effective, but considerably more efficient and less burdensome, than the required audit. Requiring an independent audit of internal control over financial reporting is duplicative of work performed by a company's internal audit function and senior management and has resulted in the cost, burden and frustration arising from the PCAOB's Auditing Standard No. 2. Public auditors are interpreting their responsibilities under the standard quite broadly and, in an effort to avoid future liability, are erring on the side of doing too much, rather than not doing enough.

We urged the PCAOB to rethink whether a separate audit of internal controls is really necessary and scale back these standards to a reasonable level of inquiry that allows an auditor to opine on the conclusions reached by management. There are other protections recently put in place that will protect the investing public and that make a more burdensome standard inappropriate. For instance, the chief executive officer and chief financial officer must certify each quarter as to the accuracy of the company's financial statements and their responsibility for establishing and maintaining internal controls. They also must certify that the internal controls have been designed to provide reasonable assurance about the reliability of the financial statements and that they have evaluated the effectiveness of the internal controls. The certifications with regard to the accuracy of the financial statements are made under the threat of criminal liability if the officer knowingly makes a false certification. These new requirements coupled with a thorough review of management's assessment of the internal control environment by the external auditor should provide the protections needed by investors.

If the SEC and the PCAOB do not extend a full exemption to depository institutions, we urge the agencies to consider revising the section 404 approach for them in light of the other significant protections available to investors of a highly regulated depository institution. If the agencies do not believe that this would be warranted for all public depository institutions, then we urge that a partial exemption from section 404 for the depository institutions exempt from the Part 363 internal control reporting requirements be granted either through a change in the regulations or a change in the law by Congress. The federal banking regulators recognized years ago that

internal control reporting and attestation requirements for the smaller community banks would be unduly burdensome, so the requirements were applied only to those institutions with $500 million or more in assets. The agencies felt comfortable with this approach because these smaller institutions are still subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations.

Acceleration of Filing Deadlines

Over the course of the last few years after passage of SOX, the SEC has accelerated the filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and insider beneficial ownership reports under section 16. Unlike larger companies, smaller public community banks do not have employees on staff dedicated to filing these reports so either have to divert attention from other matters to meet stringent deadlines or hire outside help. The two business day deadline for section 16 reports is particularly difficult because these reports are required from principal shareholders, directors and executive officers, and a certain amount of coordination with these parties must be arranged. Also, in light of the significant number of items that now must be reported on Form 8-K, the new four-business day filing requirement takes its toll on staff. Smaller companies do not have the staff resources to handle the increasing amount of information that has to be filed. Also, shorter deadlines only encourage those investors who already have a short-term outlook on investments when it seems prudent to encourage longer-term investment objectives.

We suggest that the deadlines for insured depository institutions be changed to 10 calendar days for filing current reports on Form 8-K and section 16 beneficial ownership reports.

When the SEC accelerated the deadlines for periodic reports, it provided an exemption from the new deadlines for smaller companies. However, larger companies are also now experiencing problems with the deadlines in light of the substantial work that must be done to comply with SOX section 404. Therefore, the SEC and the agencies should consider freezing the current deadlines that are now in place rather than phasing in the final step in the acceleration schedule that would require annual reports be filed within 60 days and interim reports be filed within 35 days.

Annual Independent Audits and Reporting Requirements (Part 363)

In 1991, the exemption from the external independent audit and internal control requirements in Part 363 for depository institutions with less than $500 million in assets was adequate. With the increasing consolidation of the banking industry, coupled with the application by external auditors of the public company auditing standard to FDICIA banks, this exemption threshold needs to be increased to reduce burden on the smaller institutions. We have heard that many privately held and mutual community banks with assets between $500 million and $1 billion are experiencing substantial audit fee increases coupled with serious strains on internal resources in complying with the FDICIA requirements. We believe an increase in the threshold to $1 billion in assets will provide much needed relief for these institutions.

Transactions with Affiliates

The Federal Reserve Board issued Regulation W at the end of 2002 to implement sections 23A and 23B of the Federal Reserve Act. ACB has the following suggestions for reducing the burden of this regulation.

All state bank subsidiaries should be exempt from the requirements and restrictions of Regulation W, other than those subsidiaries that engage in activities specifically mentioned in section 121(d) of the Gramm-Leach-Bliley Act (i.e., subsidiaries engaging as principal in activities that would only be permissible for a national bank to conduct through a financial subsidiary). Also, Regulation W should exempt any subsidiary relationship that would not have been subject to sections 23A and 23B prior to the date that Regulation W was issued. These exemptions were supported by an FDIC proposed rulemaking in 2004. The activities of these subsidiaries, while not authorized for national banks to perform directly, have been conducted safely and prudently for some time. The activities are authorized by state law and must comply with the requirements of the Federal Deposit Insurance Act, the FDIC's regulations, and prudential conditions in any approval order. Nothing in the history of these subsidiaries' operations suggests safety and soundness concerns that would warrant wholesale application of Regulation W.

If this exemption is deemed to be too broad, then we request an exemption to be extended at least for those state bank subsidiaries that engage only in agency activities. Agency activities typically do not require the same level of capital investment as other subsidiaries and generally do not pose significant risks to their parent depository institutions. The regulatory burden associated with applying Regulation W to these types of subsidiaries is not justified by any incremental supervisory benefits that might result.

The definition of "general purpose credit card" set forth in section 223.16(c)(4) is unduly restrictive in limiting the percentage of transactions involving the purchase of goods and services from an affiliate to 25 percent. So long as a majority of these transactions is between bank customers and nonaffiliated parties, this exemption should be available.

Frequency of Safety and Soundness Examinations

Safety and soundness exams are conducted on an annual basis, except that smaller depository institutions that meet certain requirements are examined on an 18-month cycle. One of those requirements is that the institution have assets of $250 million or less. ACB believes that this threshold should be increased to at least $500 million. Institutions that cross over the $250 threshold experience significantly increased burden from more intense examinations conducted more frequently. These institutions still are quite small and they have limited staff resources to devote to the examination process. We believe a higher threshold would be appropriate in light of the protection afforded by the other requirements of the less frequent exam cycle: the institution must be well capitalized and well managed, have one of the two highest ratings from its previous examination, and not be subject to any formal enforcement proceeding or order. Furthermore, the regulators have the authority to conduct more frequent examinations, as they may deem necessary.

Financial Management Policies

Section 563.170(d) of the rules and regulations of the OTS requires a savings association to have a resolution passed by its board of directors and a certified copy sent to the Regional Director before transferring records, or the maintenance of records, from or between the home office or any branch or service office. ACB recommends that this requirement be deleted or that only an after-the-fact written notice of a transfer to the Regional Director be required if records are transferred from a home office to a branch or service office, or from a branch or service office to the home office or another branch or service office. As long as maintenance and possession of the records are kept under the control of the savings association and not sent to a third party, an after-the-fact letter should be sufficient.

Section 563.170(e) requires that a savings association provide at least 90 days notice prior to maintaining any of its records by means of data processing services. This notice requirement should be deleted or reduced to 30 days.

Rules on the Issuance and Sale of Institution Securities

The requirement in section 563.5 that savings association certificates must include a statement about the lack of FDIC insurance should be moved to a place where it is adjacent to relevant material and can be more easily found. For example, the requirement would be more appropriate in section 552.6-3, which discusses the certificates for savings association shares generally.

Securities Offerings.

The notice requirements in sections 563g.4(c) and 563g.12 should be deleted as it should not be necessary to report the results of an offering 30 days after the first sale, every six months during the offering, and then again 30 days after the last sale.

Recordkeeping and Confirmation of Securities Transactions Effected by Banks

The FDIC, OCC and the Federal Reserve should conform their rules to those of the OTS and permit quarterly statements, rather than monthly statements, be sent for transactions in cash management sweep accounts. This will reduce the burden for national and state-chartered banks without adversely affecting bank customers. Most investment companies provide statements on a quarterly basis and customers are comfortable with this level of frequency.

Appraisal Standards for Federally Related Transactions

Each of the agencies requires that appraisals on residential real estate be conducted by state certified or state licensed appraisers for federally related transactions in excess of $250,000. We urge each of the agencies to amend its regulations to reflect the home price appreciation and inflation that has occurred in the years since the adoption of the final appraisal regulations in 1992. We suggest amending the regulation to aligning the threshold with the current conforming loan limits for Fannie Mae and Freddie Mac. As the conforming loan limit increases (or decreases), the threshold would increase (or decrease). When the final regulation was adopted

the conforming loan limit was $202,300. Today it is $359,650, but the exemption threshold has remained unchanged.

This disparity puts federally regulated institutions at a disadvantage to their non-regulated competitors. It also disregards the innovations in automated loan underwriting and automated valuation models that are in such wide usage today. These innovations in underwriting and valuing property help lenders compete for business by providing simplified property evaluations, reducing borrowers' costs, and accelerating the loan approval process. For example, a typical automated valuation report obtained via the Internet costs about $30 and is very reliable, while it costs approximately $300 to hire a state certified appraiser.

Conclusion

We live in a world where criminals seek to abuse our financial system and terrorists plot to change our way of life. We understand that anti-money laundering laws and regulations are necessary, but believe that the implementation of anti-money laundering requirements can be improved. Bottomline, the intentions behind these rules may be grounded in doing good yet their implementation is causing very real and measurable harm. Legitimate customers are being denied service and banks are being forced to adhere to an unattainable standard of perfect compliance. Without real regulatory relief our country will lose more community banks that opt out of burden.

ACB strongly urges the federal banking agencies to use this stage of the EGRPRA project to look at BSA oversight anew. We specifically request the agencies to articulate clear policy and ensure that the regional offices carry out that policy consistently. We again express our appreciation for the newly released MSB guidance and urge the agencies to work with FinCEN to produce further guidance on suspicious activity reporting and OFAC compliance.

We also urge the agencies to review the requirements of SOX as they are imposed on insured depository institutions. We stand ready to work with the agencies as this regulatory relief project progresses. We appreciate the opportunity to provide comments on all of these important matters. Please do not hesitate to contact the undersigned at (202) 857 3121 or cbahin@acbankers.org if you have questions about any of the issues addressed in this letter.

Sincerely,

Charlotte M. Bahin

Charlotte M. Bahin
Senior Vice President, Regulatory Affairs

December 23, 2004

William J. Fox
Director
Financial Crimes Enforcement Network
2070 Chain Bridge Road, Suite 200
Vienna, VA 22182

Re: SAR Resource Guide and Regulatory Issues

Dear Director Fox:

America's Community Bankers (ACB)[12] has been pleased to work with the Financial Crimes Enforcement Network (FinCEN) to provide feedback regarding various Bank Secrecy Act (BSA) related issues, including the development of new regulations to implement the USA Patriot Act. We wish to continue that relationship by making additional suggestions for improving BSA compliance, particularly in the area of suspicious activity reporting.

ACB requests FinCEN, as administrator of the BSA, to provide an updated, centralized resource guide regarding suspicious activity reporting that 1) helps institutions understand what kinds of transactions and occurrences are suspicious and reportable and 2) addresses other SAR related issues and frequently asked questions (FAQ's). We believe that such centralized guidance would be a helpful resource to community bankers and may be one way to help reduce the problem of defensive SAR filing.

Suspicious activity reporting has taken on new significance in our post-September 11th world, and FinCEN and the federal banking regulators expect institutions of all sizes and geographic locations to institute policies and procedures to detect possible illegal activity. In this era of increased regulatory scrutiny, community banks deserve more guidance and information. Otherwise, the anti-money laundering demands imposed on them are very unfair.

[12] America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

Accordingly, we request FinCEN to compile a comprehensive guide to SAR reporting that includes:

1. A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity triggers a SAR filing?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question is also important in helping to separate those occurrences that should not be reported to FinCEN. We also encourage FinCEN to include examples or case studies where SARs are or are not warranted.

2. FAQ's and key points made by previous SAR Activity Reviews. We appreciate the efforts of FinCEN to compile the semi-annual SAR Activity Review. This publication has been helpful in communicating SAR tips, trends, and issues, and we strongly urge FinCEN to continue to publish this document. However, we believe that it would be helpful to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:

    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. We understand that the federal banking agencies are working to finalize interagency BSA examination procedures. We believe that the exam procedures will help clarify the regulators' BSA expectations, but we are skeptical that the procedures will provide a comprehensive suspicious activity reporting guide for community bankers. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (Dec 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

The uncertainty surrounding whether to file a SAR is compounded by the fact that many bankers have heard FinCEN's plea not to file defensive SARs. Simply requesting institutions not to file defensive SARs will not eliminate this problem. FinCEN must help institutions understand how to separate the wheat from the chaff and must work to ensure that the banking regulators do not create a culture that motivates institutions to file unnecessarily. ACB members are generally sympathetic to the problems created by

defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

One community banker recently told of an instance where he was unsure whether certain activity should be deemed suspicious. He called FinCEN's regulatory helpline only to be told that FinCEN does not comment on whether a particular activity triggers a SAR reporting obligation. While FinCEN obviously cannot comment without knowing all of the facts and circumstances surrounding a particular case, this instance is illustrative of the dilemma faced by many community bankers who are unsure whether to file a SAR.

ACB urges FinCEN to give serious consideration to our request for the development of an updated, centralized, comprehensive guide to suspicious activity reporting. Such a resource would be helpful to community banks, and ultimately law enforcement, as we pursue our common goal of preventing terrorism and other crimes. We also trust that FinCEN will work with the federal banking agencies to help eliminate the contradictory messages that are being sent about suspicious activity reporting.

ACB looks forward to working with FinCEN on this and other issues pertaining to BSA compliance. Please contact the undersigned at 202-857-3121 or Krista Shonk at 202-857-3187 should you have any questions. Thank you for your consideration.

Sincerely,

Charlotte M. Bahin
Senior Vice President
Regulatory Affairs